MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE COMPANY
GENERAL RATE APPLICATION
FOR 2009/10 INSURANCE YEAR

Before Board Panel:
Graham Lane - Board Chairman
Eric Jorgensen - Board Member
Alain Molgat - Board Member

HELD AT:
Public Utilities Board
400, 330 Portage Avenue
Winnipeg, Manitoba
September 23rd, 2008
Pages 297 to 476

Pages 1 to

APPEARANCES

Walter Saranchuk		)Board Counsel
Candace Everard		)
Kevin McCulloch		)Manitoba Public Insurance
Raymond Oakes		)CMMG
Byron Williams		)CAC/MSOS
Nick Roberts	(np)	)Manitoba Used Car Dealers
		)Association
Donna Wankling		)CAA Manitoba
Jerry Kruk		)
Robert Dawson	(np)	)CBA/MBA
Claudio Sousa	(np)	)Scootering Manitoba

TABLE OF CONTENTS

UNDERTAKINGS

--- Upon commencing at 9:05 a.m.

THE CHAIRPERSON: Okay, good morning, everyone. Ms. Everard is going to continue the cross-examination for the Board.

Ms. Everard...?

MPI PANEL:

WARD KEITH, Resumed

DON PALMER, Resumed

MARILYN MCLAREN, Resumed

OTTMAR KRAMER, Resumed

CROSS-EXAMINATION BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Thank you. I'm going to begin this morning by dealing with issues relating to investment income. I take it that the Corporation agrees that investment income is a major component of its operating results?

MR. OTTMAR KRAMER: Yes, it is a significant component.

MS. CANDACE EVERARD: And as such it is important to rate setting. You would agree?

MR. OTTMAR KRAMER: Yes.

MS. CANDACE EVERARD: If I can ask you to turn to Tab 11 of the Board's book of documents, which is the answer to question 8 posed by the Board in the first round of Information Requests, and in particular the table at 8(a) of that IR.

If I'm reading the top table correctly, reflects that as of the year ending 2007/2008 the corporate total investment portfolio was comprised of about $2.1 billion. Is that right?

MR. OTTMAR KRAMER: The two million one eighty-seven (2,187,000,000)? Yes.

MS. CANDACE EVERARD: That being two billion one hundred eighty-seven million (2,187,000,000) and change?

MR. OTTMAR KRAMER: Correct.

MS. CANDACE EVERARD: And that, for that particular year, was comprised of a 130 million in cash and short-term investments; 417 million in equities; 1.6 billion in long-term bonds. together with 7 million in venture capital; is that right?

MR. OTTMAR KRAMER: Yes, that is correct.

MS. CANDACE EVERARD: And following that particular table across, is it correct that the portfolio is forecast to total approximately 2.2 billion at the end of the current year and to increase from there?

MR. OTTMAR KRAMER: Yes, that's correct.

MS. CANDACE EVERARD: Such that through the end of the outlook period 2012/13 the portfolio is expected to total approximately $3 billion?

MR. OTTMAR KRAMER: Yes, that's the current forecast.

MS. CANDACE EVERARD: Now I understand that these projections do not take into account or contemplate the new asset mix?

MR. OTTMAR KRAMER: Yes, that is correct.

MS. CANDACE EVERARD: Can you explain why that's the case? It may be of some assistance that there is some information on the record in II-4 second round question 4 posed by the Board?

(BRIEF PAUSE)

MR. DON PALMER: Under the new asset mix that's been filed in the new investment policy statement, there is really fairly wide ranges in a lot of the new asset classes. It's going to take us a number of years to get there. We don't know the exact timing of -- of that, so to really -- it would bd be more -- no more than a speculation exercise to have that kind of split over the next number of years.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Thank you. Staying for the moment with Table 8-A -- or Undertaking 8-A, and if we look at the middle table on that attachment, which is entitled "Investment Income," it would appear that the largest component of investment returns is from long term bonds.

Is that correct?

MR. OTTMAR KRAMER: Yes, that's correct.

MS. CANDACE EVERARD: And this is due to the significant weighting of that component in the portfolio?

MR. OTTMAR KRAMER: Yes, long term bonds is the largest portion of our entire corporate investments.

MS. CANDACE EVERARD: And if I'm reading this correctly, the subtotal of investment income to the Corporation for last year, 2007/2008, was some $142.4 million, is that right?

MR. OTTMAR KRAMER: Yes, that is correct for '07/'08.

MS. CANDACE EVERARD: And that is forecast to drop to 112.7 million in the current year, and 119 million in the year of the application?

MR. OTTMAR KRAMER: Yes, that's correct. Those are the forecasts.

MS. CANDACE EVERARD: Can you explain why there is a reduction that is being forecast?

MR. OTTMAR KRAMER: The main reason for that reduction from 07/08 to 08/09, you can see it's on the equity gain/lost category. The gains that were realized in '07 and '08 are significantly higher than are anticipated to be realized in '08/'09 and '09/'10.

MS. CANDACE EVERARD: For the current year, and this is reflected on the -- the next page, 1-8(b)(2), the Corporation is currently projecting $8 million in equity gains for the current year?

MR. OTTMAR KRAMER: Yes, that's the current forecast.

MS. CANDACE EVERARD: And that is revised, or reduced, from a previous projection of 20.2 million?

MR. OTTMAR KRAMER: Yes, that's correct.

MS. CANDACE EVERARD: And why is the reduction in equity gains being forecasted?

MR. OTTMAR KRAMER: The reduction relative to last year's projection is primarily due to reduced rates in the market.

Our equity returns are based on long term bonds, plus equity risk premium of 1 1/2 percent. As the long term bond rates fall, so do the overall returns of the equities, and that -- that's why the -- the equity gain or loss has -- has decreased.

MS. CANDACE EVERARD: And we'll speak a little bit more about that forecasting methodology later.

Can you tell us whether the Corporation has realized any gains in the current year to date?

MR. OTTMAR KRAMER: Yes, we have realized some gains.

MS. CANDACE EVERARD: Are you able to provide us with those details now, or can you give me an undertaking to do so?

MR. OTTMAR KRAMER: Yes, I can take that as an undertaking. I don't have that information with me right now.

--- UNDERTAKING NO. 7: MPI to provide Board details of the gains in the current year to date

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Thank you. Turning back to the middle table on 1-8(a), the one (1) entitled "Investment Income," we note that there are some deductions from investment income; namely, management fees and pension fund transfer.

Can you explain how the management fees are determined?

(BRIEF PAUSE)

MR. DON PALMER: Management fees are a percentage of assets under management.

MS. CANDACE EVERARD: And to whom are those fees paid?

MR. DON PALMER: All the investment managers that would -- we have -- are -- are bond managers in the Province of Manitoba. We have a number of equity managers as well.

MS. CANDACE EVERARD: And can you also explain the pension fund transfer that's reflected in this schedule?

MR. OTTMAR KRAMER: The pension fund transfer -- because the -- our -- our investment portfolio includes investments for our liabilities which include our pension liabilities, a portion of the return from the investments has to be deducted to fund for the pension liability.

MS. CANDACE EVERARD: Thank you. Now,

the third table or the final table on 1-8(a) reflects investment yields; is that correct?

MR. OTTMAR KRAMER: Yes, that's -- that's the average yields.

MS. CANDACE EVERARD: And it would appear that the short-term bond yield rates looking at that first line in the current year are forecasted to be about 2.95 percent and are projected to increase to approximately 5 percent through the outlook period?

MR. OTTMAR KRAMER: Yes, that's our current forecast.

MS. CANDACE EVERARD: And for long-term bond yield rates, again looking at the current year 2008/2009 the forecast is 3.86 percent and that yield percentage is projected to increase to 5.75 percent through the outlook period?

MR. OTTMAR KRAMER: Yes, that is correct.

MS. CANDACE EVERARD: Is the Corporation satisfied with the level of returns it has received and is forecasting for its bonds?

(BRIEF PAUSE)

MR. OTTMAR KRAMER: Yes, those -- those are the rates that are basically in the market right now and we're just achieving market rates.

MS. CANDACE EVERARD: I'm just going to go back very briefly to the pension fund transfer line in the second table.

Looking at the number for 2008/2009, the $8.8 million transfer, can you explain the -- the decrease in that number from the actual figure of 13.5 million in the previous year?

(BRIEF PAUSE)

MR. OTTMAR KRAMER: The -- the primary driver of that was when we discount the pension liabilities there was a change in the discount rate, and that's noted in our annual report, and the discount rate decreased and -- and therefore additional funds were transferred out of investments into the pension.

MS. CANDACE EVERARD: Thank you. Returning then to the third table on the same page 1-8(a), and looking at the yield percentages relating to equities, it would appear that the percentage was 8.14 percent in 2006/2007 and that increased in 2007/08 to 12.25 percent?

MR. OTTMAR KRAMER: Yes, those are the -- are the actuals for '07/'08 and '06/'07.

MS. CANDACE EVERARD: And the forecast for the current year is a decrease to 5.36 percent followed by a projected increase to 5.79 percent for the year of the application?

MR. OTTMAR KRAMER: Yes, that is correct.

MS. CANDACE EVERARD: And what is the cause of the decrease from '07/'08 to the subsequent years?

MR. OTTMAR KRAMER: The long-term equities are -- are forecasted to yield long-term bond rates plus an equity risk premium of 1 1/2 percent. So as the long-term bond rates drop, so do the equity returns.

MS. CANDACE EVERARD: So the Corporation does not use historical returns on equities to forecast equity returns going forward?

MR. OTTMAR KRAMER: No, currently we -- we use the -- the long-term bond rates plus an equity risk premium. I believe we introduced that equity risk premium about two (2) years ago in -- in that rate application and we've been using the long-term bond rates as a proxy in the past.

MS. CANDACE EVERARD: Thank you. Turning to Tab 16 of the book of documents, which is the question and answer posed by the Board in the first round, number

17, this deals with interest rates, projected interest rates. I take it that the projected yields are based on the median interest rates from each of the institutions listed at sub (a) of the response. Is that right?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And it would appear from the answer that the forecasts are based on projected interest rates from February, in the case of CIBC, and in the balance of the cases, March, 2008?

MR. DON PALMER: Yes, that's the time frame that we do our -- both our revenue and our claims forecast -- casting for the rate application so that's the -- why they're all in that sort of February/March time period.

MS. CANDACE EVERARD: So does the Corporation update the yield forecasts from time to time as new information becomes available?

MR. DON PALMER: We're always monitoring the interest rates, yes.

MS. CANDACE EVERARD: So the Corporation has received updates to these projected rates from say April of 2008, forward?

MR. DON PALMER: I'm not sure exactly the frequency of these publications. So as they come in, we subscribe, but I don't know if we have specific changes to these since that March time period.

MS. CANDACE EVERARD: Would you undertake to have a look and, if there are subsequent updates and analyses, to provide the same to the Board?

MR. DON PALMER: We can do that.

--- UNDERTAKING NO. 8: MPI to provide Board with subsequent updates and analyses of projected rates

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Now as set out at 1-17(b), the median forecasted rate for -- from these sources was used for the period prior to 2010?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And as per the next sentence, a longer term forecast is based on the global insight rate which is subject to a form of smoothing?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Can you explain why the smoothing process is undertaken and how it impacts the forecast period?

MR. DON PALMER: The long-term forecast -- you have a short-term forecast and a longer term forecast and there's a bump between the two (2). It's just a means that we can -- because we don't really think that all of a sudden there will be that -- that one (1) bump at that period of time. It's just two (2) sources of forecast and we smooth out the -- the sources of those two (2).

MS. CANDACE EVERARD: So if no smoothing was undertaken, how would the yield assumptions be impacted?

MR. DON PALMER: They would go up slightly.

MS. CANDACE EVERARD: So when you say "slightly," would it be fair to say that if there was no smoothing, there would not be a significant impact on the assumptions used in the GRA?

MR. DON PALMER: It wouldn't be material, no.

MS. CANDACE EVERARD: Thank you. Going to ask you to turn back to Tab 11 which is the question and answer at 1-8, posed by the Board in the first round. This time I'd like you to turn to Attachment C.

MR. DON PALMER: I have it.

MS. CANDACE EVERARD: I'm reading this table correctly, it sets out for a five (5) year period, the forecast projected an actual investment income for the Corporation?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: So if we start at the far right of the table for 2003/04, we see that the corporate total of investment income was originally projected at 78 million, and came in under actual at a 129 million?

MR. DON PALMER: That's net of fees and pension transfer, yes.

MS. CANDACE EVERARD: Yeah. And if we look at the next year, 2004/2005, on the same line -- so after taking into account those deductions -- the original projected was 81 million, and the actual was 88 million?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And the next year, 2005/2006, the original projected amount was 82 million, and the actual was a 166 million?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And for 2006/2007, the projected amount was 86 million, the actual was 120 million.

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And similarly, for 2007/2008, the projected amount was 95 million, the actual 125 million.

MR. DON PALMER: That's also correct.

MS. CANDACE EVERARD: So according to this particular five (5) year period, the trend, if we can call it that, is that the final outcome is significantly higher than the original projection on which the GRA is based?

MR. DON PALMER: I don't think I would call it a trend. I would call it an observation.

MS. CANDACE EVERARD: An observation that one can apply consistently in each of these five (5) years?

MR. DON PALMER: Yes, and I think if we had extended this table one (1) -- one (1) further back, you would have seen the opposite.

MS. CANDACE EVERARD: Looking at the equity gain or loss line in the same table, which is a few lines up, and -- and looking across that line, it would be fair to say that that's a significant factor in the bottom line results that we've been reviewing?

In other words, if we look at that line, again starting from the right, from '03/'04 across, comparing the original projected number to the actual number, we can see that the projection was always considerably less than was actually made?

MR. DON PALMER: That's correct.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Now, for the year of the application, and we touched on this briefly a moment ago, the Corporation is forecasting 119 million in investment income. Just briefly flip back to Table A, the middle table, for that number. And included in that is 11.3 million in equity gains.

MR. OTTMAR KRAMER: Yes, that's correct.

MS. CANDACE EVERARD: Does the Corporation agree that variances from assumed rates of return will have consequences on the RSR?

MR. OTTMAR KRAMER: Yes, it can be both positive and negative.

MS. CANDACE EVERARD: Can you just explain how that relates?

MR. OTTMAR KRAMER: As -- as you just discussed for the response to 8(1)(c), to the extent that -- that equity returns are higher, that will increase the investment income, and also increase the net income of the Corporation.

But as I just pointed out earlier, the -- if -- if the returns were the opposite, depending on the -- the market conditions that are at play at that particular time, what we're living through currently with the volatility of the market, if the equity returns are less it would have a negative impact on the investment income, and hence on the RSR also.

MS. CANDACE EVERARD: Thank you. I'm going to ask you to turn to question 18 posed by the Board in the first round, which is not in the book, and in particular, Attachment C to that IR, which is a recast of TI-15(a), reflecting the equity yield rates shown in the Aon report.

Are you with me?

MR. OTTMAR KRAMER: Yes.

MR. BYRON WILLIAMS: Ms. Everard, I apologize, it's Mr. Williams here, could you just provide the reference again?

MS. CANDACE EVERARD: Oh, sure. It's question 18 posed by the Board first round, Attachment C, which is part of the answer to 1-18(b), recasting TI-15(a).

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Now this recasting of TI-15(a) reflects $98 million in investment income forecast for the current year, 2008/2009, and 102.9 million for 2009/10.

MR. OTTMAR KRAMER: That's -- you're referring to 1-18(b), Attachment C?

MS. CANDACE EVERARD: Yes.

MR. OTTMAR KRAMER: Yes, that's correct.

MS. CANDACE EVERARD: And then continuing through the outlook period, the investment income line is noted to increase to 110 million through to 133 million at the end of the outlook period?

MR. OTTMAR KRAMER: Yes, that is correct based on those assumptions.

MS. CANDACE EVERARD: Now the original TI-15(a) filed by the Corporation, which is found at Tab 7 of the book of documents, for obvious reasons reflects lesser investment income through the same period?

MR. OTTMAR KRAMER: Yes, that is correct.

MS. CANDACE EVERARD: So -- just so we're all clear, if we're looking at both of the schedules together, the answer that forms part of eighteen (18), the recast based on the higher yields, reflects for the year of the application a hundred and 102.9 million in investment income, compared with ninety-one point nine (91.9) originally projected, so a difference of about 10.9 million?

MR. OTTMAR KRAMER: Yes, that would be an increase of ten point nine (10.9).

MS. CANDACE EVERARD: And in the next year the number projected in the revised schedule is 110.3 million compared with 101.6 million provided -- or projected originally by the Corporation, which would be a difference of about 8.6 million?

MR. OTTMAR KRAMER: Yes, that's -- that's fairly close, yeah.

MS. CANDACE EVERARD: And in the next year 2011/'12 the comparison is 122 million to 114.4 million, which is a difference of about 7.7 million?

MR. OTTMAR KRAMER: Yes, that's correct.

MS. CANDACE EVERARD: And lastly, 2012/'13 the recasted schedule provides for investment income of 133.4 million, compared with a hundred and twenty-four point seven (124.7) originally projected by the Corporation, so a difference of about eight point eight (8.8)?

MR. OTTMAR KRAMER: Yes. It's close. I haven't done the math in my head, but yeah it's close.

MS. CANDACE EVERARD: Fair. So would you be willing to agree that if we add together the four (4) differences that we've just gone through, the first one being ten point nine (10.9), the second one being eight point six (8.6), the third one being seven point seven (7.7) and the fourth one being eight point eight (8.8), that the total difference over the four (4) year period is about 36 million?

MR. OTTMAR KRAMER: Yes that would be close.

MS. CANDACE EVERARD: Now there's been evidence given a couple of times already this morning that the forecasting that the Corporation does with respect to equity gains is based on long term bond rates plus an equity risk premium.

It's my understanding that bond rates are at historical lows and I think that's been mentioned as well.

MR. OTTMAR KRAMER: I -- I'm not sure if its -- I don't know, you know, the bond rates ten (10), fifteen (15), twenty (20) years ago but for -- for the immediate past, yes they are at a low.

MS. CANDACE EVERARD: I think actually it is on the record that they're at a forty (40) year low and I can take you to --

MR. OTTMAR KRAMER: I -- I've just received confirmation that that is correct.

MS. CANDACE EVERARD: Okay. In -- in fairness I'm not trying to be tricky; it is -- it is on the record and one (1) of the IR response is that the long term bond rates are currently at forty (40) year lows. It's at part of 1-10.

So in that circumstance, is the Corporation considering or does it think it would be appropriate to consider using something other than long term bond rates and an equity risk premium to set these forecasts?

MR. DON PALMER: No. I -- I think we've -- in your previous cross-examination, have established that we are forecasting the long term bond rates to increase over the next -- over the forecast period. I think we're happy with the -- the assumption of a equity risk -- risk premium as it currently stands.

MS. CANDACE EVERARD: And the Corporation doesn't think that considering any other factors would be appropriate at this point?

MR. DON PALMER: There are a number of ways that you could do it. I -- I think the -- the use of an equity risk premium is very common in forecasting investment income. And on that basis, we're -- we're happy with that.

MS. CANDACE EVERARD: All right. So I am going to ask you to turn to 1-13 posed by the Board in the first round, which I don't believe -- oh, it is in the book of documents, pardon me. It's at Tab 13 of the book of documents.

So we discussed earlier this morning the total value of the portfolio, and how that is projected to change through the outlook period. Looking at the -- this particular response, it would be fair to say that the relative weightings in the portfolio for 2008/2009 have not changed substantially over that -- from last year, except for maybe short term bonds?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Now can you explain for the record why there was a fairly significant relative change in the short term bond component of the portfolio from '07/'08 of 5.8 percent to the current year of 3 percent?

MR. DON PALMER: That would be a transfer into cash in preparation for a rebate.

MS. CANDACE EVERARD: That would be the rebate ordered by the Board last year?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Now I take it that the information set out in these tables does not reflect the upcoming new portfolio mix?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And would that be for the same reason that you've given us already this morning?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: One (1) of the components, as has been mentioned briefly in the portfolio, is venture capital; can you explain what that consists of?

(BRIEF PAUSE)

MR. DON PALMER: We'll take that as an undertaking.

Did -- did you want specifics, or -- or sort of a general explanation?

MS. CANDACE EVERARD: Well I think the question I asked was for a general explanation, but I was going to come to specifics, so if you're giving me the Undertaking, it's all good.

MR. DON PALMER: We'll do it altogether.

--- UNDERTAKING NO. 9: MPI to explain to Board the specifics of what venture capital consists of

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Okay. I'm going to move then to get into some questioning about the Aon report.

As the record reflects, the Corporation retained Aon Consulting to undertake an asset liability mix review. That's right?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And I understand that the Corporation worked with Aon collaboratively through its investment committee working group, or ICWG?

MR. DON PALMER: Yes, that's true.

MS. CANDACE EVERARD: And for the purposes of the record, we'll probably just call it the working group.

MR. DON PALMER: That's fine.

MS. CANDACE EVERARD: Now who participated in the working group from the Corporation?

MR. DON PALMER: The working group consists of members of both MPI and the Department of Finance.

In terms of the MPI representatives, they're myself, Mr. Kramer, Mr. Bunsten (phonetic) who is Manager of Investments. I can't forget Ms. McLaren is on the working group. Our manager of Treasury and Disbursements is on the working group as well.

MS. CANDACE EVERARD: And who are the representatives of the Department of Finance that sit on the working group?

MR. DON PALMER: There are three (3) members: The Assistant Deputy Minister, the other two (2) were our managers within the Department of Finance; I don't have their exact titles but I can get them for you.

That -- that would be four (4) members not three (3).

MS. CANDACE EVERARD: Thank you. Now I'm going to take you to some specific excerpts of the report.

THE CHAIRPERSON: Ms. Everard, just a minute. Are the members from Finance investment professionals?

MR. DON PALMER: Yes.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: So I -- I am going to go through some specific excerpts of the report, but just as a general proposition can you tell the Board whether the Corporation, or the working group, or both, were able to provide input into the drafting of the final report?

MR. DON PALMER: There was some input, yes.

MS. CANDACE EVERARD: Pursuant to the

contract entered into between the Corporation and Aon certainly that was built right in that -- that the Corporation could have input into the final product?

MR. DON PALMER: Sure.

MS. CANDACE EVERARD: Okay, if you can turn to Tab 8 of the Board's book of documents where you'll find just some excerpts of the Aon report, not the whole thing.

MR. DON PALMER: I have it.

MS. CANDACE EVERARD: You can turn to the bottom of page 11 -- or page 11 and then look at the bottom which is part of Section 4.

And I'm looking specifically at the bullet that's entitled, "Projection of Surplus Distribution/Increased Premium," and you'll see that there are four (4) bullets that follow that heading that go onto page 12.

Could you read those four (4) bullets into the record please?

MR. DON PALMER: Sure.

"Bullet 1: As per the Public Utility Board's Order, Number 1-50/07, there will be a surplus distribution in 2008/'09. After this likely distribution, surplus distributions and increased premiums each year appear to be approximately equal throughout the projection period.

Bullet 2: In any given year, the probability of there being no surplus distribution or additional premium is generally between 30 and 40 percent. Thus policyholders can expect to receive an adjustment, either a refund or a premium increase in 60 to 70 percent of the next fifteen (15) years.

Bullet 3: It is worth noting that the RSR rules as currently drafted serve largely to stabilize the retained earnings rather than stabilizing the rates paid by policyholders where rates are considered to be basic rates surplus distributions and additional premiums.

Annual application of the RSR rules rather than a longer period such as three (3) years and a very tight RSR ban, relative to the size of the portfolio, will result in rather unable rates paid by or refunded to

policyholders.
Bullet 4: In addition, the RSR rules put a large amount of focus on one (1) year results. This focus on one (1) year results may cause the company to assume an inappropriately low level of risk relative to the level of risk that may be -- might be assumed if the RSR rules were to be applied less frequently, say tri-annually."

MS. CANDACE EVERARD: Thank you. Now as part of the record in this proceeding the Corporation has provided electronically the previous drafts of this document, that's part of Question 5(b) that the Board posed in the second round.

You're familiar with that?

MR. DON PALMER: Yes, I am.

MS. CANDACE EVERARD: Now we've noted that these last two (2) bullets of the four (4) that -- that you read in, the third and the fourth one, were not included in earlier drafts of this report?

MR. DON PALMER: Yes, I agree with that.

MS. CANDACE EVERARD: We'll come back to that in a minute. I just want to focus on, for the moment, the third bullet where its -- it reads in the first line:

"It is worth noting that the RSR rules as currently drafted serve largely to stabilize retained earnings." Et cetera.

Can you explain what the Corporation's understanding of RSR rules are? What -- what does that term or what is that term intended to mean in this paragraph?

MR. DON PALMER: That RSR rules would be the -- the levels set by the Public Utilities Board. So not rules as -- as how it's established but the levels therein.

MS. CANDACE EVERARD: And continuing on that bullet, the word "rates," as it's used in the second line in the phrase:

"Rather than stabilizing the rates paid by policyholders, rates are meant to be basic rates, surplus distributions, and additional premiums."

MR. DON PALMER: That's what it says, yes. That's correct.

MS. CANDACE EVERARD: We're agreed though that the issuance of rebate cheques in the past -- at least in the recent years -- have not changed the rates so they're not adjustments to the rates?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Continuing in that paragraph --

MR. DON PALMER: I'd just like to say that that's Aon's language, not ours.

MS. CANDACE EVERARD: I understand but you're the one I get to cross-examine right now, so we'll go from there.

So continuing in that bullet, the last sentence reads:

"Annual application of the RSR rules rather than a longer period such as three (3) years and a very tight RSR band, relative to the size of the portfolio..." Et cetera, et cetera.

Can you give me an idea of what is meant by the phrase, "a very tight RSR band"?

MR. DON PALMER: The -- that would be the -- the difference between the bottom of the range and the top of the range of some -- I think it's about $40 million range right now. For a company of -- of our size, certainly we've seen fluctuations of -- of that over a number of years, so that would be what I would consider a tight band just because you could have variance in results exceeding that -- that bandwidth.

MS. CANDACE EVERARD: And just following into the last phrase of that sentence, still on the third bullet, there's the statement that:

"These factors will result in rather unstable rates paid by or refunded to policyholders."

So why is it being suggested that there will be instability or unstable rates?

MR. DON PALMER: Again, in their language, premiums net of or including surplus rebates so there could be changes if -- if we went under the -- the level. I mean, we may have to have increased rates to -- to build back to the range of the RSR.

MS. CANDACE EVERARD: Looking at...

(BRIEF PAUSE)

MS. CANDACE EVERARD: Looking at the fourth bullet, there's the phrase in the first sentence:

"In addition, the RSR rules put a large amount of focus on one (1) year results."

What does that phrase mean?

MR. DON PALMER: If we were to go beyond

the top of the range in one (1) given year, because we have made -- pick a number -- $50/$60 million it's likely and -- and we've seen that -- that would result in a premium rebate. Certainly, that $60 million in one (1) year could be followed by a $70 or $80 million loss in the second year. After you had refunded, bringing you down to the -- the top of the range, which is generally what the surplus rebates have done, and then you loose $80 million, all of a sudden you're underneath the bottom of that range, and we would have to probably get some sort of premium relief for that -- that difference.

MS. CANDACE EVERARD: But we're agreed, though, that the RSR is cumulative. In other words, it builds over a period of years?

MR. DON PALMER: Oh, sure, but in my example, say -- and assume the top of the range is -- is $100 million, and we were above that range to a hundred and fifty (150), and a rebate was -- was ordered to bring us down to the $50 million -- to -- to $100 million. The following year, we loose $60 million, and all of a sudden the RSR is underneath the range by some $10 million.

So -- so that's -- I -- I understand it's cumulative, but when you have a rebate it -- it goes away.

MS. CANDACE EVERARD: So you're basically saying that the RSR range impacts risk to the Corporation.

MR. DON PALMER: Sure. That -- that's really what it's there for.

MS. CANDACE EVERARD: So it's your thought that a larger range would reduce this risk, or volatility?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: We've been focussing on the third and fourth bullet in this particular section; to what extent did the Corporation have input into the content of these two (2) bulleted paragraphs?

MR. DON PALMER: As you've pointed out, there was discussions on a number of -- of the areas in this report, but there was no specific direction given to add these -- these sentences into the report, no.

MS. CANDACE EVERARD: That was going to be my next question, was whether those bullets reflect the position of the Corporation, or whether they were authored by Aon.

MR. DON PALMER: These are authored by Aon.

MS. CANDACE EVERARD: I want to take you to page 3 of the Aon report, which isn't in this excerpt in the book of documents, so you'll just want to grab the report itself, which I think is AI-11.

(BRIEF PAUSE)

MR. DON PALMER: I have the report.

MS. CANDACE EVERARD: Thank you. There's a footnote at the bottom of page 3, which relates to the investment perspective that's referenced in the second paragraph.

MR. DON PALMER: Yes?

MS. CANDACE EVERARD: The footnote reads:

> We recognize that there may be non-investment factors that could make separate asset mixes for separate liabilities attractive. However, any analysis of these non-investment factors are beyond the scope of this report.

This footnote, from our review, was not in the first draft of the report, but obviously is in the final draft.

Do you agree with that?

MR. DON PALMER: Subject to check, but sure, I will agree with that.

MS. CANDACE EVERARD: Does the Corporation have any further commentary on this footnote?

MR. DON PALMER: No.

THE CHAIRPERSON: What would the other non-investment factors be?

MR. DON PALMER: We did -- did mention briefly yesterday when we talked about segregation of assets for other purposes, the ownership of -- of surplus, and the ownership of those assets, for instance, that's really not part of -- part of this. That would be the main one.

There could be separate reporting considerations as well if a private company were -- have to report to pension benefits branch or something like that as well.

(BRIEF PAUSE)

MS. CANDACE EVERARD: You're going to want to keep your finger on page 3 just for your information.

I understand that on December 14th of 2007, Aon made a PowerPoint presentation to the Corporation, and that would have been very early on in this -- in their engagement?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And I understand that at that presentation the -- it was -- it was provided to the Corporation that there were two (2) goals that Aon was to achieve in its study. Are you familiar with those?

MR. DON PALMER: Yes. Is there a specific reference you're -- you're looking at?

MS. CANDACE EVERARD: You know, not exactly. I think it was part of 2-5 which was circulated electronically so it's not handy. I -- I have a hard copy of it here which we can...

MR. DON PALMER: I think we've -- we've got it.

MS. CANDACE EVERARD: So I'm looking at page 3 of the PowerPoint which is one (1) of the slides entitled, "Executive Summary."

MR. DON PALMER: That's the one (1) that has the asset mix on it?

MS. CANDACE EVERARD: It has, yes, some information about the asset mix, but the first bullet reads: "The goal of this study is to determine..."

MR. DON PALMER: Yes, I have it.

MS. CANDACE EVERARD: Okay. So can you read into the record the goals that are set out in this particular slide?

MR. DON PALMER:

"In this particular slide [which was the presentation made on December 14th] the goal of the study is to determine investment allocation strategies that will maintain retained earnings within the RSR band established by the PUB primary objective; and secondly, to maximize return. In particular, maximize likelihood of attaining a 5 percent return. Secondary objective."

MS. CANDACE EVERARD: And at this point in time, that is December of 2007, how or by whom were these goals set?

(BRIEF PAUSE)

MR. DON PALMER: This was set by Aon specifically, yes.

MS. CANDACE EVERARD: Now, I had asked you to keep your finger on page 3 of the report because it reflects in the last full paragraph on page 3, two (2), what I would say are different objectives.

Can you read that paragraph into the

record for me from page 3?

MR. DON PALMER:

"Based on the input from MPI, the objectives for the strategic asset mix are as follows:

Primary: Minimize the tracking error of the assets relative to the liabilities; and Secondary: Maximize returns subject to a reas -- reasonable levels of risk."

MS. CANDACE EVERARD: I take it from the opening phrase of that paragraph based on the input from MPI that the Corporation had input into the changing of these objectives?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Can you explain how that came about and why?

MR. DON PALMER: In this first presentation of December 14th we looked at that -- the RSR band established by PUB. We thought really that was a -- maybe a bit artificial. Certainly, although we know that we are under the jurisdiction of the PUB for this particular, it's really not part of our overall asset strategy. We have, you know, bigger -- bigger goals than to just present things to the PUB, if I can be so bold.

So we thought essentially to -- to give that maybe a little bit more global perspective, to -- to have an objective that again talked about minimizing large fluctuations and risk. And really to the biggest risk that we have is -- is big fluctuations in -- in liabilities and a mismatch with assets.

So we really wanted to focus in on an asset liability matching strategy or -- or an asset -- yeah, a matching strategy that would offset the risks of the assets and liabilities.

Essentially, the objective to maintain within the RSR band established by the PUB and minimizing the error between assets and liabilities gets you to the same place.

It's just this second objective is a little more global in scope.

(BRIEF PAUSE)

MR. DON PALMER: I think just to -- to expand on that again, the RSR band within PUB is a year-by-year measurement. And again, we're looking at a longer time horizon than that.

MS. CANDACE EVERARD: Okay. Thank you.

Still with the PowerPoint slides from

December 2007, the asset mix that was proposed by Aon at that point, which I have in my points and I don't appear to have in my slide so I can't tell you what slide number it is, but it's fairly close to the end.

MR. DON PALMER: There is a recommended asset mix on slide 4.

MS. CANDACE EVERARD: Thank you. That is the one. So it would be fair to say that what's reflected on slide 4 was the asset mix that Aon put forward in December 2007?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And if I'm reading this correctly, Aon proposed 10 percent in mortgages, that's on the second row, and 45 percent in long-term bonds?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Now in Aon's final report, and we'll go back to Tab 8 of the book of documents, it provided the Corporation with two (2) recommended portfolios?

One which was its main --

MR. DON PALMER: Can you give me -- sorry, Ms. Everard. Do you have a page number? I -- I've got the whole report open and it will help me.

MS. CANDACE EVERARD: Probably the

easiest is if we just go to the Executive Summary which is page number 1 of the report.

It provides a handy chart that sets out the distinctions between the Corporation's current mix, the recommended portfolio from Aon, and then the alternative recommended portfolio.

MR. DON PALMER: Yes, I have that.

MS. CANDACE EVERARD: So when I say that Aon provided the Corporation with two (2) alternative portfolios, those are the two (2) that I'm referring to. Would you agree?

MR. DON PALMER: I would agree, yes.

MS. CANDACE EVERARD: Just -- before we go any further with that, so keep your finger on page 1, I just want to ask one (1) follow-up question related to the objectives for the Aon study.

Would you say that the results of the model would change if the objectives were changed?

MR. DON PALMER: That was our question too after our December 14th meeting and they didn't.

MS. CANDACE EVERARD: Thank you. So looking back at the book of documents and the excerpts of the Aon report that appear there, Aon noted -- and I'm now on page 2 of the executive summary in the second full paragraph, second sentence -- that the conclusion which it reached, was that MPI's current portfolio was fairly reasonable in terms of providing an accepted -- or acceptable, pardon me, expected level of return.

MR. DON PALMER: Sorry, Ms. Everard. Again, where is that sentence?

MS. CANDACE EVERARD: Sure. Page 2 of the executive summary, second full paragraph, second sentence. So it -- the sentence reads:

"On the contrary, in our analysis we concluded that the current portfolio is fairly reasonable in terms or providing an acceptable expected return level..." Et cetera.

MR. DON PALMER: Yes, I see that.

MS. CANDACE EVERARD: So the point being that even though Aon concluded that the current portfolio was fairly reasonable in terms of return level.

And then that sentence continues to say:

"Also a low risk of asset liability mismatch..."

Aon still came up with two (2) alternative portfolios in their recommendations that it considered to be superior to the current portfolio?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: If we turn to

Appendix G of the report, which is included at the same tab; it's page 69 of the Aon report.

MR. DON PALMER: That would be labelled "Benchmark Portfolio returns"?

MS. CANDACE EVERARD: That's the one. We see a comparison of historical returns in the Corporation's portfolio versus the suggested returns in the two (2) portfolios recommended by Aon. Is that fair to say?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And this reflects that, generally speaking, the Corporation would have had higher returns if it had either of the recommended portfolios put forward by Aon?

MR. DON PALMER: Generally that's true, yes.

MS. CANDACE EVERARD: I appreciate that the six (6) month rates in the far right column don't reflect that but the others do.

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: If we turn the page to the first page of Appendix H, which is page 70 of the report, still at Tab 8 of the book of documents, can you explain what this chart represents?

MR. DON PALMER: That's the risk reward

relationship with the excess return. That one?

MS. CANDACE EVERARD: That's the one.

MR. DON PALMER: This is commonly known as an efficient frontier which trades off risk and return of various different portfolios. The line that would be made up if you had collected all of -- or connected the yellow dots, and I'm hoping you're looking at a -- a colour copy, is points for each one of those return levels that you can't get a higher return level without assuming a higher risk.

So -- so anything below that line connecting the yellow dots would not be optimal. You could always get a higher return at the same risk level.

MS. CANDACE EVERARD: And -- and in this particular case, the yellow squares represent the portfolio suggested by Aon?

MR. DON PALMER: They would -- could you repeat that question because I'm not sure it was quite right.

MS. CANDACE EVERARD: Oh, that's fair. I appreciate what you said about the -- the yellow squares representing the highest possible returns without having an increased risk. But what I'm asking is whether in this particular graph, and I -- I accept your answer about what the yellow squares represent, but do they do not also specifically represent the portfolio or portfolios suggested by Aon?

MR. DON PALMER: The recommended would be one (1) of those yellow dots. Each one of those yellow dots is an -- is a different asset mix, so -- so they -- they have determined the universe of optimal selections, depending on what risk level that the Corporation would be comfortable with.

It was their selection based on what -- what our -- our meetings that we would be at the sort of lower level in the risk spectrum.

MS. CANDACE EVERARD: So if I understand what you're saying correctly, the yellow square that's numbered five (5) and the yellow square that's numbered ten (10) would be the two (2) -- represent the two (2) portfolios that Aon suggested to the Corporation?

(BRIEF PAUSE)

MR. DON PALMER: Not quite. With the different assumptions, you get different efficient frontiers.

So there is another chart, but on this particular one (1), they would have recommended dot number five (5).

MS. CANDACE EVERARD: When you say "dot

number five (5)," you mean yellow square number five (5)?

MR. DON PALMER: Yellow square number five (5), yes.

MS. CANDACE EVERARD: There's a lot of dots on that chart. So --

MR. DON PALMER: Only the yellow ones are numbered.

MS. CANDACE EVERARD: So -- just so that we're clear, yellow square which is numbered five (5) would represent Aon's suggested portfolio number 5, and the yellow square that is numbered ten (10) would represent Aon's suggested portfolio, Number 10?

MR. DON PALMER: No. Number 10 was with a different assumption mis -- mix. It's a different chart.

MS. CANDACE EVERARD: Okay.

MS. MARILYN MCLAREN: Just to clarify, if you go back to page 69 --

MS. CANDACE EVERARD: Yes.

MS. MARILYN MCLAREN: -- you can see that recommended portfolio, Portfolio 5, from Chart 3, which is on page 26, and then you can see alternative recommended portfolio, Portfolio 10, is from Chart 5. So it's -- they're from a different base. So the five (5) and the ten (10) don't come from the same efficient frontier.

They're not that different, but they're from a different set of assumptions.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So how do the efficient frontiers of Portfolio 5 and Portfolio 10 as suggested by Aon compare with that of the portfolio ultimately selected by the Corporation?

MR. DON PALMER: We used the MPI assumptions, which are the base assumptions, which would be Chart 3 on page 26.

MS. CANDACE EVERARD: That's just what I wanted to clarify.

MR. DON PALMER: Chart 3, and the one (1) on page -- page 70 are -- are on the same basis. That Appendix H.

MS. CANDACE EVERARD: Okay. So if we look at the one (1) -- I'll just look at the one (1) on page 70 because it's in front of me. We talked about the yellow squares. The light green triangle, which appears on the chart, represents the portfolio ultimately selected by the Corporation, is that right?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And the red circle on the same chart represents the current MPI portfolio prior to any changes being implemented?

MR. DON PALMER: That's also correct, yes.

MS. CANDACE EVERARD: So am -- am I reading this correctly if I say that if you look at the relative placement of the red circle and the green triangle and the yellow squares, that the portfolio selected by the Corporation while having a more favourable placement than the current portfolio or the red circle, is less favourable than the yellow squares, being the recommended portfolio?

MR. DON PALMER: It would have a lower expected return at the same risk level than number eleven (11), yes.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So the portfolio that was selected by the Corporation is sub-optimal as compared with that recommended?

MR. DON PALMER: Sorry, could you repeat that question?

MS. CANDACE EVERARD: Sure. So the

portfolio selected by the Corporation is sub-optimal as compared to the portfolio recommended?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Okay. There was a question posed to the Corporation in the first round, which is Question 10, and that answer appears at Tab 12 of the book of documents.

And that question in sub (a) related to how and why the Corporation selected what it selected and how that resulted from what Aon recommended, and it's a fairly lengthy answer that we're going to break down and go through piece by piece.

So if we look at page 1 of the response under subheading (a), the Corporation has said in the second paragraph that the working group changed the allocation targets for a few reasons: First, the working group was uncomfortable with the wholesale switch from universe bonds to long-term bonds, given the fact that long-term bond rates are currently at forty (40) year lows. And I'm just going to stop there.

Can you explain for the Board what are the relative characteristics of a universe bond as compared with a long-term bond?

MR. DON PALMER: Universe bonds would have different...

(BRIEF PAUSE)

MR. DON PALMER: ...would be both short and long and include both corporate bonds and government bonds.

MS. CANDACE EVERARD: Whereas long-term bonds would have a maturity of over ten (10) years?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Would you agree that returns on long-term bonds are usually higher than that of universe bonds?

MR. DON PALMER: Generally that has been the case, yes.

MS. CANDACE EVERARD: Did the working group look at the long-term historical yields on long-term bonds versus that of universe bonds?

MR. DON PALMER: That's part of our consideration, yes.

MS. CANDACE EVERARD: And as has already been said this morning, the Corporation doesn't necessarily anticipate the very low rates to continue for long-term?

MR. DON PALMER: That would likely be true, yes.

MS. CANDACE EVERARD: Okay. Continuing

on in the narrative portion of this answer where I left off, the next sentence -- this is at the top of page 2, response to question 10 reads:

> "In addition, due to the relatively low spread between the yield on long-term bonds and the yield on universe bonds, there was little advantage to such a switch."

What is the spread at present?

MR. DON PALMER: We don't have it right at our fingertips but we'll get that for you.

--- UNDERTAKING NO. 10: MPI to indicate to Board the spread between the yield on long-term bonds and the yield on universe bonds

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Thank you. And following on that, can you advise of whether that spread is expected to widen going forward?

(BRIEF PAUSE)

MR. DON PALMER: It's really hard to say

at this point.

MS. CANDACE EVERARD: So you're declining to provide an undertaking on that just so the record's clear?

MR. DON PALMER: It's -- either way it's speculation.

MS. CANDACE EVERARD: I'm sure you will have had an opportunity to review the report that's been prepared and filed in this proceeding by CAC/MSOS, the one authored by Drs. Hum and Simpson.

They comment that -- and this is on page 7 of their report. You don't necessarily have to go there but just for your information and for the record. They say on page 7 that the Corporation -- they note that it did not accept Aon's advice with respect to the waiting of long-term bonds in the portfolio, and then they say that in theory long-term bonds should give a higher return and that liquidity should not be a concern to the Corporation.

And they say that that is the case because the Corporation should operate with virtually an infinite horizon, no wind-down date coming down the road, and the fact that its obligations will not all become due on the one (1) date.

What is the Corporation's view of that

assessment by Drs. Hum and Simpson?

MR. DON PALMER: The assessment that we have infinite horizon, certainly I would agree with that. Even within our current liability structure, we have liabilities and -- and disability payments that will probably be paid for sixty (60) years plus.

So we do have -- even within our existing portfolio -- have a very long time horizon, so I -- I would agree with that.

MS. CANDACE EVERARD: What does the Corporation say would be the implications of doing a gradual switch over to long-term bonds?

(BRIEF PAUSE)

MR. DON PALMER: I think over time we -- that's our plan, to go to long-term bonds, but there are a number of considerations in terms of -- of selling existing bonds. And -- and we don't want to have a wholesale changeover of our portfolio because that also introduces some risk that we don't necessarily want to take.

That -- that timing will be up to the Department of Finance to do when it's favourable to do so.

MS. CANDACE EVERARD: Aon suggested in its report a transitioning option, so is that something that is being considered or will be considered when the -- the change goes?

MR. DON PALMER: Could you give me a reference, please?

MS. CANDACE EVERARD: Oh sure, page 34 of the AON report, which you will not find -- oh, hang on, maybe I'm lying.

I don't think it's at the excerpts that appear at Tab 8 of the book of documents, I think you'll have to go to the report itself. Yeah, that's correct. You'll have to go to the report.

(BRIEF PAUSE)

MR. DON PALMER: Okay. I -- I have it, I've just quickly reviewed it and could you repeat the question please?

MS. CANDACE EVERARD: The question was you -- you said a moment ago that the Corporation does plan to invest in long-term bonds but needs to have regard to the timing and that kind of thing.

So the question is: Aon suggested a transitioning strategy on page 34, is that something that the working group will give consideration to or has it done so already?

MR. DON PALMER: Those particular timing decisions are up to DOF.

MS. CANDACE EVERARD: "DOF" standing for Department of Finance?

MR. DON PALMER: Sorry, yes.

MS. CANDACE EVERARD: Coming back for a moment to the report prepared by Drs. Hum and Simpson. They recommend what they call a laddering technique, which they call the process of staggering the maturity of bonds in the portfolio.

What is the Corporation's view of that suggestion?

MR. DON PALMER: First, we do have bonds right across the maturity spectrum today. That looked to be kind of a buy-and-hold strategy to match cashflows. We would call that strategy probably a little naive. Seems to preclude active trading of bonds, as Department of Finance does, to take advantage of some -- some spreads that happened from -- from time to time.

So it seems to be their -- their way of doing a cashflow matching which could minimize risk; although certainly when those long bonds mature, you could get some interest rate risk -- comes in.

We mitigate that a couple of ways. We have a duration matching strategy which matches our duration of our bonds with our liabilities. That, in fact, is built into our investment policy statement, so it -- it's that -- that risk is mitigated with that duration matching.

We have also mitigated the risk on the income statement, or started to, with the designation of our bonds "as held for trading" and I'm sure we'll get into that later on this afternoon or tomorrow.

So -- so I would call the Hum and Simpson laddering method an attempt at mitigation of risk, which we already do, and I think it's quite frankly, a little naive for us to -- to be able to match our cashflows on the basis that they have recommended in their laddering approach.

MS. CANDACE EVERARD: So the Corporation doesn't agree that implementing that type of strategy would enable it to have sufficient liquidity over time as well as holding bonds with higher yields and returns?

MR. DON PALMER: We -- we don't really need the liquidity for the portfolio. If -- if you're equating the liquidity to risk, I think it's risk that we already take steps to mitigate.

MS. CANDACE EVERARD: And at present,

what portion of the Corporation's bond portfolio matures annually?

MR. DON PALMER: I don't know what the answer to that is but I will also say that it's probably not really relevant because we don't hold our -- most of our long-term bonds on a -- to maturity, we're actively trading all the time. We -- we turn over about 40 percent of the portfolio on an annual basis.

MS. CANDACE EVERARD: Just a question to try to try to tie in your evidence with respect to the Hum and Simpson laddering technique, which you suggested you thought was naive -- or the Corporation's position is that it's naive.

How does that fit in with the transitioning alternative put forward by Aon? How do you reconcile those?

(BRIEF PAUSE)

MR. DON PALMER: I -- I don't really see that they're reconcilable. Again, one (1) would be based on an active trading approach rather than buying with the intent of holding bonds to maturity so I don't know that there is -- that it's possible to reconcile.

MS. CANDACE EVERARD: One (1) further

question for now and then I think we'll take our morning break with the Board's permission.

When does the Corporation intend to -- or -- or does it, I mean I know you said that with respect to this purchasing of -- of additional long-term bonds the timing is up to the Department of Finance. Does the Corporation intend to have any input or attempt to have any input into that process unfolding?

MR. DON PALMER: We are always in contact with the Department of Finance, certainly in contact with the working group and our discussions therein so it's certainly a topic that will come but the -- the decision as -- as bond traders are theirs.

MS. CANDACE EVERARD: Can you give us any idea of a ballpark of the timeframe that we're looking at?

MR. DON PALMER: It depends on the spreads and -- and what -- the advantageous timing from the experts at the Department of Finance.

THE CHAIRPERSON: Just before we take our break, a few other questions before I lose the thread of the discussion.

Mr. Palmer, if you don't mind, in simple terms what is or are the risk or risks that the Aon portfolio recommendations seek to avoid or minimize?

MR. DON PALMER: The main would be timing risk to interest rate risk. Certainly the -- if you're talking in terms of the bond portfolio, there would be a default risk I suppose.

Within the whole portfolio structure you've got mainly a timing risk. You've got a return risk. Certainly when you look in -- in the equities the return -- rate of returns can be -- can fluctuate more than within a bond portfolio.

But certainly as interest rates change over time, your -- you can get some -- some change in value. And certainly if you look at a mismatch between assets and liabilities, as interest rates change, let's say interest rates go down, the value of your bonds will go up but also your liabilities will go up. So -- so you're trying to match that as much as you can.

We did go into a little more detail in PUB round 1, question 4, if that's of help to the Chair.

THE CHAIRPERSON: Thank you.

Was Aon working on the assumption that a loss driven by reduced investment income that resulted in the Board-determined RSR minimum being above the actual would lead to a premium increase for the following year?

(BRIEF PAUSE)

MR. DON PALMER: Could you repeat that question, please, Mr. Chairman?

THE CHAIRPERSON: Was Aon working on the assumption that a loss that came about as a result of reduced investment income, that led to the RSR being below the Board-determined minimum, that that would result in pressure on a premium increase for the following year?

Was that its assumption?

MR. DON PALMER: Yes.

THE CHAIRPERSON: Was the avoidance of a loss in a single year as a result of investment income decline, a factor in the portfolio recommendations of Aon?

MR. DON PALMER: No. I -- I think as they match the change in the liabilities would be a bigger factor. I -- I think the overall financial position of the Corporation taking into account both assets and liabilities would be the bigger concern.

THE CHAIRPERSON: Are you talking about just Basic or the whole Corporation?

MR. DON PALMER: The -- the asset/liability study was for the Corporation's entire portfolio, but certainly the -- the lion's share would be for Basic. So -- so I think the -- the statement is --

is true whether you're talking in terms of Basic or -- or the entire Corporation.

THE CHAIRPERSON: Your last question, though, kind of confused me a little bit given the -- the "yes" to the one before.

You're saying that Aon was not concerned about the portfolio composition being such to run the risk of a loss occurring because of the decline in investments?

MR. DON PALMER: To the extent that your asset/liability mismatch would -- would change that. And -- and remember as interest rates go up, your value of your assets go down but your liabilities also go down, so -- so you look at the whole package, not the asset side in -- in isolation.

THE CHAIRPERSON: I'll have to think about that one, thanks. Were any portfolios that were looked at, did any of them involve degrees of mismatch?

MR. DON PALMER: They all have mismatch in them. It's -- it's a question of controlling that mismatch and mitigating the effect of that mismatch.

THE CHAIRPERSON: Just a simple question. How does MPI view its investment portfolio? Is it viewed as a means to meet future liabilities or is a means to both: meet future liabilities and assist with premium reduction?

MS. MARILYN MCLAREN: The latter. And I think that if -- if I can elaborate maybe for a minute or two (2), Mr. Chairman, it sort goes back to the conversation about the changing objectives.

And I think it's also important to -- I believe it's important to reinforce what I believe I heard Mr. Palmer said, is when the objectives changed the outcome -- the portfolios and the allocations and the outcome didn't change. They have a methodology. At the heart of their methodology is trying to match assets and liabilities over the long term.

Clearly that's what the Corporation's trying to do, is to make sure that the future is well in hand; that is absolutely the priority. But -- and as the objectives that we settled on we say -- that is -- match the assets of -- this is an asset/liability study, it's not a minimizing RSR volatility study.

And when we looked at -- and I think it was when -- when the executive members of the ICWG looked at the early work in December and said this is really not appropriately reflecting what we're trying to do here.

Taken to the extreme even if, you know, this Board believed that what we were really just trying to do is keep everything in that -- by some's opinion, tight RSR band, we'd sit there in bonds and probably wouldn't even actively trade them.

Clearly, previous Board orders indicate that that's not the expectation or desire or preferences of this Board, so that's why we tried to settle on something that was probably from a little bit higher perspective: An approach that said this is an ALM, let's try our best to match the assets and liabilities, minimize the tracking error, but get a return with an acceptable level of risk.

And that's why we've ended up actually with a fair bit more risk, significantly more return. But absolutely, we all need to understand that means more annual volatility.

And when we looked at this result -- now going back to the four (4) bullets that we talked about, the latter two (2) that didn't show up in the early report, the role that MPI played in that is to ask the question:

Okay, so what, based on your first two (2) bullets and based on the objectives then, what does this mean? What is this likely to -- how is this likely to play out?

In your expert opinion AON, what does this mean in terms of your first of your first two (2) bullets? And that's when they came back with their next two (2) bullets.

So it really was trying to provide a perspective within the entire context of what we -- we were seriously trying to accomplish is a more appropriate asset allocation mix for the long-term benefit of ratepayers. That's what we're all about.

And I think it's just important to put that context on it because we know there will be volatility; probably a little bit more than there has been.

We believe it's -- it's worth -- worth that because of the enhanced return; that's what it's about. But I think it's really important to sort of understand that given the environment within which we are. The RSR band and, you know, sort of the band of the target is really more a constraint than an objective, but it's not a constraint that drives decisions for the long-term benefit of ratepayers.

THE CHAIRPERSON: Thank you. Just one (1) last short one with respect to Mr. Palmer.

It's your understanding that bond yields always reflect a premium over their rate of inflation on liabilities? Are they married?

MR. DON PALMER: They tend to move

together, so -- so I wouldn't say that they're directly married. Your -- your real return may vary somewhat but -- but generally that would be true.

THE CHAIRPERSON: Okay. Thanks. We'll have our break now.

MR. DON PALMER: Mr. Chairman --

MR. DAVID CHIASSON: Yes, Mr. Palmer?

MR. DON PALMER: -- if I may, I just want to correct the record on one (1) thing. I -- I directed the Chair to PUB-1-4; that -- that in fact is a completely erroneous reference that just happened to be on the sheet of paper I was looking at so I didn't want to send the Chair on a wild goose chase.

THE CHAIRPERSON: Don't worry. Someone will direct me to the right one. Thanks.

--- Upon recessing at 10:40 a.m.

--- Upon resuming at 11:06 a.m.

THE CHAIRPERSON: Whenever you're ready, Ms. Everard.

MS. CANDACE EVERARD: Thank you, Mr. Chairman.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: So just prior to the break we were looking at the answer to Question 10 posed by the Board in the first round dealing with the evolution of the Aon recommendations and where the Corporation ended up.

We covered the first reason identified by the working group as to why the allocation targets were changed dealing with universe versus long-term bonds. If I can direct your attention to page 2 of the same IR which is at Tab 12 of the book of documents, the first full paragraph on page 2 where it is set out the second reason why the allocation was changed. The first paragraph reads:

> "Second, the ICWG, Investment Committee Working Group, disagreed with the recommendation to allocate significantly more to US equities than to Canadian equities, particularly in light of a superior performance of the Canadian equity market over the last nine (9) years."

Are you with me?

MR. DON PALMER: I'm right there.

MS. CANDACE EVERARD: So keep your finger on that, but if you can turn to Tab 15 of the book of documents which is the response to Question 16 posed by the Board in the first round, it would appear, if I'm reading this table correctly, that the Corporation had no investments in the US other than equity swaps prior to the year ending in 2005.

Is that right?

(BRIEF PAUSE)

MR. DON PALMER: That's true, although we would consider the equity swaps to be US equities.

MS. CANDACE EVERARD: The Corporation has testified in past proceedings that one (1) of the reasons that it didn't invest in the US market was currency risk. Is that still a valid concern to the Corporation in light of the current relative value between US and Canadian dollars?

MR. DON PALMER: I would like -- the reference to that, but we -- we do hedge our currency risk. It's -- it's fully hedged so we don't have that currency risk, so -- so I'm not quite sure where that reference comes from.

(BRIEF PAUSE)

MS. CANDACE EVERARD: I don't have a -- a specific transcript page number or anything of that sort, but it's -- it's our recollection that a couple of years ago, your predecessor, Mr. Galenzoski, testified to that effect.

MR. DON PALMER: Let's just say that currently we don't have that currency risk because it's fully hedged, and -- and has been since we went to the US equities.

MS. CANDACE EVERARD: And Aon has recommended that hedging continue?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Did the working group look at the historical returns from the US stock exchange compared to the Canadian exchange in reaching its decision not to increase investment in US equities?

MR. DON PALMER: Yes, that was one (1) of the considerations.

MS. CANDACE EVERARD: Would it be fair to say that investing in the US market, which is broader than the Canadian market, would provide an opportunity for greater returns, as well as diversification?

MR. DON PALMER: The greater diversification I would likely agree with. As far as the returns, that's speculation.

MS. CANDACE EVERARD: Okay. Turning back to Tab 12 of the book of documents, and the answer to question 10, page 2, the next full paragraph, the one (1) that deals with the third reason why the allocation mix was changed, can you read in that paragraph?

MR. DON PALMER: The one (1) that start -- starts with, Third?

"Third, adoption of the Aon recommended portfolio, portfolio number 5, would have required the sale of approximately $1 billion of securities and the purchase of a similar amount. Such a significant volume of transactions would have been very costly. Finally, portfolio number 5 provided only marginal return benefits over the current portfolio compared to other portfolios on the efficient frontier."

MS. CANDACE EVERARD: Can you give the Board an indication of what the magnitude of those costs would have been that are referenced in that paragraph?

(BRIEF PAUSE)

MR. DON PALMER: We haven't quantified

that, no.

MS. CANDACE EVERARD: Would it be fair to say that the costs would be reduced by implementing the new portfolio over time, as suggested by Aon?

MR. DON PALMER: The costs are the costs, so no, I don't think that minimized the -- the effect, although certainly spread out over a longer time horizon, but -- but in terms of total quantum, no I wouldn't agree with that.

MS. CANDACE EVERARD: Okay. So having discussed the three (3) reasons why the allocation mix represented by Aon was not acceptable to the Corporation, we understand that the Corporation had Aon run an additional scenario, which is known in the materials as "Modified Portfolio 11"?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Now it's referenced in this IR response number 10, the same one (1) we've been looking at, page 2, that Modified Portfolio 11 was based upon the Aon portfolio numbered 11, at least that's how I read this.

Is that right?

MR. DON PALMER: That was the starting point, yes.

MS. CANDACE EVERARD: I just want to

clarify that because it appears from a review of the content of portfolio 11 in the Aon report that it -- Aon's portfolio 14 actually looks more similar in terms of the content to the one that the Corporation ultimately chose so we're just trying to clarify whether Aon's original eleven (11) was actually the basis on which modified eleven (11) was formed or whether it was actually Aon 14.

(BRIEF PAUSE)

MR. DON PALMER: Could you give me the exact reference to what you're looking at, please?

MS. CANDACE EVERARD: Yeah. In section 6 of the Aon report, page 27, there's a chart that appears to reflect all of the various Aon portfolios. And if you compare that page, page 27, with page 71, which is the first page -- or second page of Appendix H, comparing the column on Appendix H that's entitled "eleven (11)", back with page 27 -- oh, just one moment.

(BRIEF PAUSE)

MS. CANDACE EVERARD: We'll just leave that point for the moment. We're not finding what we're looking for.

So the -- the evidence that the Corporation has put on the record is that Aon ran an additional scenario using the same methods and assumptions, the result of which was the modified 11 portfolio that is referenced on page 71 of the Aon report.

MR. DON PALMER: Not quite. We had the -- we had the portfolio 11 that we modified. We said we -- we'd like to make this -- a few changes to this, would you run this one? So -- so really it was our selection of modified eleven (11) came before the -- the running of that particular portfolio.

MS. CANDACE EVERARD: So how did the Corporation go about comparing the optimal portfolio suggested by Aon number five (5) and number ten (10) to that which ultimately resulted from the analysis?

(BRIEF PAUSE)

MR. DON PALMER: We essentially looked at the marginal return at given amounts of risk. Slope of the curve essentially.

MS. CANDACE EVERARD: Okay. Coming back to Tab 12 on the answer to question 10 posed by the

Board, the Corporation has provided an explanation in the last paragraph on page 2 of why it was portfolio 11 that it suggested to -- or that it selected, pardon me, to modify.

Can you explain for the Board with regard to this answer why that particular portfolio was used?

MR. DON PALMER: We felt that it provided one (1) of the best ratios of -- of return to risk without going really into the -- the much higher risk portfolios.

(BRIEF PAUSE)

MS. CANDACE EVERARD: As reflected in that paragraph the ratio of return to risk for portfolio 11 was higher than portfolio 5 recommended by Aon. What about portfolio 10 which was Aon's alternative portfolio recommendation?

MR. DON PALMER: It's -- it's a bit hard to -- to compare that since that was run on a different assumption basis.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. Going back

to the excerpts from the Aon report that are at Tab 8, and in particular page 32, there are a series of charts dealing with the risk reward relationship and I take it from looking at the previous page, page 31, that it would be the column of numbers fifth from the left that would represent portfolio 5 on page 32?

The headings for the portfolios didn't carry over from one (1) page to the next so I just want to establish that we all know what we're talking about.

(BRIEF PAUSE)

MR. DON PALMER: I know that we've really confused the issue with -- with these charts but you really should be looking at page 28. Page 32 is using the alternate assumptions.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. Thank you.

So looking at page 27, the chart is entitled, "Asset Allocation of..." -- or the first chart is entitled, "Asset Allocation of Optimal Portfolios" and then in brackets, "New Economic Scenarios."

Can you explain what the phrase, "New

Economic Scenarios" entails or refers to?

MR. DON PALMER: I'm sorry, Ms. Everard. Now you've lost me.

MS. CANDACE EVERARD: Well then we're even. I'm on page 27 of the Aon report. The first chart is entitled, "Asset Allocation of Optimum Portfolios (New Economic Scenarios)." So can you explain what that phrase, "New Economic Scenarios" entails? Okay. And then compare that to the heading of the table on page 31 which does not have that bracketed phrase?

MR. DON PALMER: The new economic scenarios would be the MPI assumptions which we wanted to align with our forecasting assumptions. So it's -- so it's really on the basis of the MPI assumptions that we built modified portfolio 11.

MS. CANDACE EVERARD: Okay. Can you summarize for the Board the differences between the two (2) sets of assumptions or direct us to where they are set out?

(BRIEF PAUSE)

MR. DON PALMER: We'll -- just to save time, we'll provide that as an undertaking.

MS. CANDACE EVERARD: Thank you.

--- UNDERTAKING NO. 11: MPI to indicate to Board the differences between the two (2) sets of forecasting assumptions or direct the Board to where they are set out

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Okay, so I think the question that I was leading up to when I took you to page 31 and then you kindly directed me to page 27 is to ask you to outline for the Board which aspects of the risk reward relationship -- so the -- the five (5) charts that start on page 27 and carry onto page 28 -- which aspects of that and those charts did the Corporation focus on or draw its attention to when comparing portfolio 5 to the figures that ultimately became included in modified portfolio 11?

(BRIEF PAUSE)

MR. DON PALMER: In the fourth chart labelled "Risk Reward Relationship of the Average Annual Fund Return," we'd be looking at the first row in that --

MS. CANDACE EVERARD: So that would be

the fifth chart of the five (5) on page 28?

(BRIEF PAUSE)

MR. DON PALMER: Where it -- it's based on that fourth chart labelled "Risk Reward Relationship of the Average Annual Fund Return" except we actually looked at the ratio of the mean to the volatility, which those -- those figures are not specifically put on this chart, but we will provide them to you.

--- UNDERTAKING NO. 12: MPI to provide Board an outline of which aspects of the risk reward relationship MPI focussed on or drew its attention to when comparing Portfolio 5 to the figures in modified portfolio 11

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Okay. Did the Corporation undertake an analysis comparison comparing the two (2) portfolios?

MR. DON PALMER: Which two (2)?

MS. CANDACE EVERARD: Number 5, number

10, that you recommended by Aon, and number 11.

MR. DON PALMER: I think that was three (3), but, yes. And -- and we'll provide you that analysis that was done. How's that?

MS. CANDACE EVERARD: Thank you.

--- UNDERTAKING NO. 13: MPI to provide Board with analysis comparison of portfolios 5, 10, and 11

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Thank you.

Turning back to Tab 12 of the book of documents, this answer at number 10 that deals with all of these issues, the Corporation has stated in the very last sentence of page 2 -- this is the same paragraph where the Corporation is explaining why it selected portfolio 11 because of the best ratio of return to risk. Last sentence reads:

> "Portfolio 11 also had other measures, probability of a rebate or increase in premiums, that were better than Aon's recommended portfolio number 5."

How did Aon's recommended portfolio number 10 compare on the same question?

MR. DON PALMER: They didn't because that's using the different set of assumptions.

MS. CANDACE EVERARD: When the working group made the selection to use portfolio 11 as is reflected in this paragraph, did it bring to Aon's attention its rationale for doing so?

(BRIEF PAUSE)

MR. DON PALMER: We did discuss the selection of modified 11 with them. We weren't looking for their validation of that.

MS. CANDACE EVERARD: Sorry, can you say that last phrase again?

MR. DON PALMER: We weren't looking for their validation of that.

MS. CANDACE EVERARD: Did the working group express to Aon its view that the modified 11 portfolio was superior to portfolio 5, and why?

MR. DON PALMER: We -- we talked about the selection of -- of portfolio 11. Anywhere on that efficient frontier, it -- it's a tradeoff, and we thought that portfolio 11 met our goals better than portfolio number 5 did.

If -- and I'm a little uncomfortable with

-- with the word "superior," we thought that it met our goals better. So if -- if that's superior, I would say that that's your words not -- not mine.

Essentially, it comes down to we were willing to accept more annual volatility than they thought we were.

MS. CANDACE EVERARD: If we turn over the page in answer 10, Tab 12, to page 3, at the very top of that page there's a summary of the changes that were made to portfolio 11, such that it became modified 11.

Can you read those in, please?

MR. DON PALMER:

"Long bonds were reduced from 40 percent to 10 percent. Universe bonds were increased from zero percent to 30 percent. Canadian equity was increased from 6 percent to 12 percent. US equity was decreased from 14 percent to 5 percent. And EAFE [that's E-A-F-E] was increased from zero percent to 3 percent."

MS. CANDACE EVERARD: And what does E-A-F-E stand for, for the record?

MR. DON PALMER: Europe, Australasia, Far East.

MS. CANDACE EVERARD: Continuing on in that answer, the next paragraph reads that:

"Aon's analysis found that the modified portfolio had similar risk and return metrics to portfolio 11."

That's right?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And that paragraph continues to read that:

"EAFE was added in order to further diversify the portfolio and to gain exposure to equity markets outside of North America."

MR. DON PALMER: Yes, and -- and just for clarification, EAFE does re -- refer to equity markets in Europe, Australasia, and Far East.

MS. CANDACE EVERARD: Did Aon provide to the Corporation any input into the adequacy of the modified 11 portfolio, other than simply recreating the outputs?

MR. DON PALMER: I'm not quite sure what you mean by "adequacy." We -- we did discuss that portfolio with them and they didn't have any strong objections to it.

MS. CANDACE EVERARD: Did they have any

opinions on it? That it was favourable, they -- they liked it, they disliked it, they thought it was good, bad, indifferent?

MR. DON PALMER: They were generally supportive of it.

MS. CANDACE EVERARD: Can you direct the Board to a reference within the Aon report of its general support for modified portfolio 11?

MR. DON PALMER: No. There -- there is no support in the report to -- to that effect.

(BRIEF PAUSE)

MS. CANDACE EVERARD: When you say that Aon was generally supportive of the modified portfolio 11, is that based on verbal discussions or is there any written correspondence or other documentation to that effect?

MR. DON PALMER: It's -- it's just verbal.

MS. CANDACE EVERARD: If I can direct your attention to page 6 of the Aon report which is not in the excerpt in the book of documents, you'll have to go to the whole of the report?

MR. DON PALMER: I'm there.

MS. CANDACE EVERARD: The first heading on page 6 is "Liability/Expenses" and the following follows under that heading:

> "We will make the following assumptions regarding future changes in premiums: Premiums will be increase to the extent that a deficit exists or the surplus is below the minimum bound of the rate stabilization reserve."

MR. DON PALMER: I see that, yes.

MS. CANDACE EVERARD: Is this not opposed to or the opposite of what you indicated earlier in response to a question from Mr. Chairman?

MR. DON PALMER: I'll have to check the transcripts but I don't think so. I think this is what I said. If it's not what I sent -- said, it's what I meant.

MS. CANDACE EVERARD: So for the purposes of the record, that is the correct position?

MR. DON PALMER: Yes.

(BRIEF PAUSE)

MR. DON PALMER: These are assumptions

that were within the report, not constraints, not -- not a recommendation that would -- we would have to act in one (1) way or another. This was the assumption that was made in the report.

MS. CANDACE EVERARD: Okay. Thank you. I'm going to move then to have some more specific discussion on the report prepared by Drs. Hum and Simpson submitted by CAC/MSOS, and in particular page 6 of that report if you have it at hand?

(BRIEF PAUSE)

MR. DON PALMER: I have it.

MS. CANDACE EVERARD: So there's a section that begins on page 6 that's entitled, "Segregating Pension Assets and Liabilities" and in the third full paragraph of that section, there's a statement that the stakeholder interest of retirees and therefore their investment goals and investment strategies will not be the same as the Corporation's. For example, pension plan members may prefer a higher rate of return or liquidity/flexibility conditions that might be incompatible with such a large portion of their portfolio and the MUSH sector and/or they might wish a larger international exposure.

Are you with me?

MR. DON PALMER: I'm there. The way that I was reading this was if there was ever a consideration of adopting a defined contribution plan.

MS. CANDACE EVERARD: And my question was going to be: Would you agree that this issue is mitigated because the Corporation does not have a defined contribution plan?

MR. DON PALMER: It's not an issue.

MS. CANDACE EVERARD: Because the Corporation in fact has a defined benefit plan which is administered under the Civil Service Superannuation Act?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: With respect to pension assets, is it fair to say that the Corporation looks at pension assets as a cross-section of its total investment portfolio sharing proportionally in interest and dividend income and realized and unrealized gains and losses?

MR. DON PALMER: In practice, I guess that's how it works. I guess I would say that we don't look at pension assets. It -- it's the -- the liabilities are separated and segregated but the assets are not. They're completely co-mingled so you -- I suppose you could make any assumptions that you wanted regarding that, but the fact is that we don't look at them on a separate basis.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Now, it's correct that included in the pension accounts is a provision for employee future benefits which is calculated on an indexed basis?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And this provision is determined annually on the basis of actuarial principles?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And it is correct that changes in experienced gains and losses are recognized in the current period for accounting purposes?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: So annually, it's determined how much will be deducted from investment income to fund the employer's share of the pension liability.

That fair to say?

MR. DON PALMER: No. I think the deduction from pension -- or from investment income might be slightly misunderstood from -- from the context of that question.

MS. CANDACE EVERARD: Well, is it correct that the pension plan obligation is a first charge so to speak against investment income which thereby reduces net income?

(BRIEF PAUSE)

MS. CANDACE EVERARD: If I can just comment. I'm not trying to be confusing. We -- there was evidence this morning with respect to deductions from investment income for a pension fund transfer and if the -- the questions that I'm asking do not seem correct to you or the content does not seem correct, then please explain why that is. What your view is.

MR. DON PALMER: In the pension valuation, there is an assumption as to future returns -- future investment returns. The discing -- the discounting of liabilities is -- is essentially that -- that you have an assumption of -- of what investment income that will attract. So that's the deduction that's made. It -- it's not the overall change in the -- the funding.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. So just to clarify, is the pension return based on the current asset mix or on a notional asset mix?

MR. OTTMAR KRAMER: The pension return is based on long-term bonds as prescribed by the CICA handbooks, so we're doing it based on a long-term bond yield. So ideally it is notional then.

MS. CANDACE EVERARD: So it's my understanding that the superannuation fund utilizes a ratio of 60 percent equity, 40 percent debt in its pension fund.

Would it be fair to say that if the Corporation had a segregated pension fund, it would likely have higher level of equity investments in line with that ratio?

(BRIEF PAUSE)

MR. DON PALMER: Pension plans in general likely would have a higher equity exposure. So whether -- I guess it would depend on our own duration of our pensions and pensioners exactly what that mix would be.

In general terms, would a pension plan

have a more aggressive mix than -- than our assets as a whole? That's likely true. But I -- I think that -- or in general if you took that chunk out, then you would have a less aggressive portfolio for the rest of the -- the liabilities.

So when you bring them all together, on average I think it worked out to be about the same.

MS. CANDACE EVERARD: So what is it about pension liabilities that generally leads to a more aggressive asset mix?

MR. DON PALMER: They're a longer term.

MS. CANDACE EVERARD: I -- I understand it is on the record and probably everyone in this room would accept that the Corporation does experience PIPP claims that can last for up to sixty (60) years.

So how do you reconcile the two (2)?

MR. DON PALMER: That -- that some of the liability but certainly not all of it. We also have liabilities of the Corporation on collision claims that will be paid out next week.

So there -- there certainly is a -- a mix of our liabilities on unpaid claims as well.

MS. CANDACE EVERARD: So can you give the Board an idea of the average duration of claim liability versus pension liability?

(BRIEF PAUSE)

MR. DON PALMER: I know the duration of the unpaid claims and unearned premium reserve is around eight (8). One (1) of the back row members thinks that the pension duration is around sixteen (16).

So it's probably reasonably close but certainly much longer than that of the unpaid claims liabilities.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Looking back at the -- this particular section in the Hum and Simpson report that we started out with a few moments ago, it's reflected at the bottom of page 6 in the subparagraph lettered (b) that the pension liabilities currently total a 137 million in 2007 but will grow steadily with expected increased volatility.

This is per the Aon report page 12. This sum is comparable to the rate stabilization reserve of 128 million in 2007, and again referencing the Aon report. And Hum and Simpson ask:

"Would the management in monitoring of a separate pension portfolio of an

amount similar in size to the RSR
require any more attention or effort."

And so my question for you, Mr. Palmer, or for the panel is: What is the Corporation's view on that question?

MR. DON PALMER: My view is I didn't understand the question in this context.

The -- the surplus of the Corporation -- the RSR, as all retained earnings, are also co-mingled with our assets so I -- I'm not sure exactly what Hum and Simpson was referring to here in terms of treating them separately. All assets of the Corporation are -- are co-mingled. So the context of this question, quite frankly I don't understand.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Would you expect that there would be a greater cost to the Corporation in terms of management fees or in terms of effort?

MR. DON PALMER: Likely there would be. Certainly much more effort and as you -- depending on how finally you segregate each piece. I mean, we're -- we're talking about segregating pension funds from the unpaid claims liabilities and then segregating RSR.

You could also look at segregating the different PIPP coverages. You -- you could say, Well, our income replacement is a different duration than our comprehensive reserves. So you could segregate them.

You could segregate your income replacement into those that are seriously injured and not seriously injured. So there -- any -- any number of ways that you could separately segregate all the liabilities the Corporation and every time that you -- you do that, you would likely increase the volatility of each piece and you would increase the management fees.

So we prefer to look at in aggregate and have each one of those liabilities contribute to the overall duration that we're looking at.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Would the cost -- and just speaking of managing the pension fund separately, would the cost of doing so be onerous in the Corporation's view?

MR. DON PALMER: In terms of onerous, probably not but it certainly -- you know, as in all the operations of the Corporation, we're looking to do in the most efficient way possible and that's not extra costs that we would care to bear.

MS. CANDACE EVERARD: If you don't agree that the costs would be onerous, would you agree to a different adjective such as "significant", "material"? Or feel free to give me one of your own?

MR. DON PALMER: How about costs that we wouldn't want to pay?

MS. CANDACE EVERARD: Thank you.

Mr. Chairman, should we break for lunch? I'm going to go to another section and it's about ten (10) to 12:00.

THE CHAIRPERSON: Very good. So we will be back at 1:15. Thank you.

--- Upon recessing at 11:54 a.m.
--- Upon resuming at 1:19 p.m.

THE CHAIRPERSON: Okay, Ms. Everard, are you read to pick up where you left off?

MS. CANDACE EVERARD: Yes, Mr. Chairman, thank you.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: I'm going to stay with the Hum and Simpson report for a few more sections.

If I could ask the panel to turn to page 8 of that report, and this is the section dealing with the amount of foreign equities in the Corporation's portfolio.

MR. DON PALMER: I have it.

MS. CANDACE EVERARD: Thank you. Drs. Hum and Simpson note in the first couple of paragraphs that both Aon and previously Mercer recommended to the Corporation less weight on Canadian equities as opposed to US or foreign equities?

MR. DON PALMER: Yes, that's true.

MS. CANDACE EVERARD: Now I understand that currently the Corporation's portfolio sets out the reverse in terms of waiting; that is -- that Canadian -- Canadian equities are weighted more heavily over the foreign equities on roughly a 4:1 basis?

(BRIEF PAUSE)

MS. CANDACE EVERARD: You want -- you want to know where I get the 4:1 from?

MR. DON PALMER: I would like to know where you get the 4:1 from.

MS. CANDACE EVERARD: The -- the 4:1 from our review came from page 4 of the Hum Simpson -- or the

Hum and Simpson report which sets out the -- under the column of "Old Target," which would be the current mix, the fifteen point five (15.5) in Canadian equities versus the three point eight (3.8) in U.S. equities which would be roughly 4:1.

MR. DON PALMER: Subject to just a quick verification, I will accept that, yes.

MS. CANDACE EVERARD: Now coming back to page 8 on the commentary on this issue in the Hum and Simpson report, basically as -- as I read this, they state that the Corporation's thinking is flawed with respect to these issues and respecting an optimal portfolio mix.

Looking at returns, and these are in the bulleted paragraphs on page 8, looking at returns as well as diversification. Are you with me?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And Drs. Hum and Simpson continue their discussion on this issue on page 9, and if I can direct your attention to the first full paragraph on page 9 which begins with the phrase, "MPI's refusal to countenance."

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Can you read that paragraph into the record, please?

MR. DON PALMER: Okay. The quote in the Hum and Simpson testimony is:

"The refusal by Aon to countenance international equity in our judgment is inexcusable. The fastest growing economies in the world include Brazil, Russia, India and China [break] and parts of Asia. The weighting for Canadian equities 12 percent relative to US 5 percent and international 3 percent appears imbalanced for an investment portfolio of MPI's size at $2 billion."

There also is a footnote in that. I don't know if you want me to read the footnote there.

MS. CANDACE EVERARD: That would be footnote four (4) or footnote five (5)?

MR. DON PALMER: Footnote five (5).

MS. CANDACE EVERARD: I think I -- maybe I misspoke but I actually had intended for you to read in the previous paragraph, the one that began "MPI's refusal to countenance." You -- by the time I realized what you were doing you were almost done so I thought I wouldn't bother interrupting you.

MR. KEVIN MCCULLOCH: Mr. Chairman, I

don't like to interrupt either and I'm -- Ms. Everard in -- in her questions has been referencing pages from the Hum and Simpson report that don't correspond with the page numbers that I have, and I just wondered if there's maybe a PUB version that --

MS. CANDACE EVERARD: I don't know. I'm -- I'm reading from a bound book that was -- I received from Mr. Williams. I made the assumption that everyone's copy would have the same pagination, but.

MR. KEVIN MCCULLOCH: Just for example, the paragraph that you referred to "MPI's refusal to countenance" et cetera appears on page 10 of -- of the copy that I have.

But it may just be a --

MR. BYRON WILLIAMS: If I may help, it may be that we sent electronic versions as well as bound versions and Ms. Everard may simply be working off the -- the bound version.

I'm not sure what you're working off of, Mr. McCulloch.

MR. KEVIN MCCULLOCH: All right, I think we can -- as -- as long as there's no difference in the wording I think we can proceed on that basis then.

THE CHAIRPERSON: We're only aware of one (1) version.

MR. BYRON WILLIAMS: As am I.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: I can tell you that this one was bound when I received it and I haven't unbound it so it -- I hope that the contents is the same. But perhaps I'll try to go by headings and the content and then we can make sure that we're all together.

So, Mr. Palmer, if you have the paragraph that begins "MPI's refusal to countenance"?

MR. DON PALMER: I'll try to get the right one this time. Again, from the Hum and Simpson report.

> "MPI's refusal to countenance a stronger position in US equities because of the superior performance recently of Canadian equities reveal some flaws in their thinking. The very fact that US and Canadian equity performances can diverge is actually prima facie evidence of the raison d'etre to diversify in a portfolio. The issue then is a matter of timing and it's probably wise to take a position in US equities precisely when

US equities are inferior to the
Canadian equity performance. In the
long run regression to the mean
suggests this will yield superior
return."

MS. CANDACE EVERARD: Thank you. Do you have a sense from that paragraph and possibly the footnote number 4 that corresponds with it, what is meant by the phrase "regression to the mean"?

(BRIEF PAUSE)

MR. DON PALMER: "Regression to the mean" essentially is the tendency to -- if you've got current divergent results that they'll revert to a longer term average.

MS. CANDACE EVERARD: Thank you. So would the Corporation consider a larger proportion of US equities in its investment portfolio if it was appropriately hedged against currency risk?

MR. DON PALMER: First, just to preface the
-- the answer, we are hedged against currency risk, so that's not really a -- a consideration.

It comes down to comfort in -- in the

Canadian market for -- for starters and that we have got good returns and, you know, being a Canadian Crown Corporation that that's part of the considerations.

I would also like to add to the fact that we're looking or -- or you're asking me these questions on a security-by-security basis.

But in the selected portfolio of MPI Modified 11, if I can call it that, we also included infrastructure and private equity that would very likely have an international component as well.

So to -- to focus in and say we don't have international equities, I think you have to look at the whole exposure of the international marketplace rather than just specifically equities.

MS. CANDACE EVERARD: Thank you. I do want to followup on a couple of the points though that -- that these individuals have made on this issue.

They suggest, and that's Drs. Hum and Simpson, that the timing may be right to take a greater position in US equities due to the recent inferior returns because they feel that in the long run yields will be superior.

What is the Corporation's view on that strategy?

MR. DON PALMER: I -- I think there is

some danger in that. I mean, maybe we've got to a new mean. You know, over the long term that might very well be their opinion. I don't know that necessarily it would be the correct opinion.

MS. CANDACE EVERARD: When you say there would be a danger in that, what danger are you thinking of?

MR. DON PALMER: That it hasn't hit -- yet hit bot -- bottom. There are certainly reports that Canadian fundamentals are probably better. There is different regulation in Canadian financials, for instance, than -- than in US financials.

Maybe it's short term, maybe it's not, and I think to -- to make an assumption that there will be a regression to the mean, there could be -- we -- we may have a -- a new starting point.

The other part of this, and -- and of course continues to come back to the fact that our portfolio, the -- the management of our portfolio is the jurisdiction of the Department of Finance. So it's their decisions more than ours that really make a difference to this.

MS. CANDACE EVERARD: Mr. Palmer, coming back to the last paragraph in this section, the one (1) that you read in the first time, I'm now coming to a question about it.

This is where Drs. Hum and Simpson take exception to the fact that Aon did not model for international equities, and they point to certain economies in -- in other parts of the world.

MR. DON PALMER: Just --

MS. CANDACE EVERARD: Was that --

MR. DON PALMER: Just a correction, and I don't know if it's Hum and Simpson misunderstand -- standing.

International equities, EAFE, were modelled by Aon, they just weren't part of the optimal mix.

MS. CANDACE EVERARD: Okay, thank you for clarifying that.

My question with respect to this paragraph was whether what Aon did model was the result of any direction from the Corporation, or whether it was independent from Aon?

MR. DON PALMER: As part of our preliminary meetings, there were some guidelines as to in broad terms what would be in or out of -- of a modelling exercise.

(BRIEF PAUSE)

MR. DON PALMER: We actually did not -- or came to the agreement that they would not model emerging markets. There is a few others that were excluded. Hedge funds were excluded. Commodities were excluded.

There's certain -- certainly a -- a risk profile that is shared by -- well, by the Department of Finance, that there are certain equity classes that we would not consider.

MS. CANDACE EVERARD: So how was the 3 percent weighting for international equities arrived at?

(BRIEF PAUSE)

MR. DON PALMER: In our discussions with -- with DOF, we were very interested in having some exposure to -- to EAFE, but not -- and given that -- that we have not had any exposure, we thought that some small asset would -- asset mix, or -- or allocation would be a good place to start.

So 3 precent seemed like that kind of -- it's significant enough, but certainly not that significant. So there was not a -- a real mathematical formula. It was arrived upon just by judgment as a good place to start because we had not been in EAFE before.

MS. CANDACE EVERARD: Thank you. I'm going to continue in the Hum and Simpson report to the next section which, in my version, is on page 9. Don't know where it is in yours but it's entitled, "The Absence of Real Return Bonds" in the MPI portfolio.

MR. DON PALMER: It's -- in the MPI version, it's on page 10.

MS. CANDACE EVERARD: Excellent.

So as is noted in the second paragraph of that section, in the Aon report it was recommended that investment in real return bonds be eliminated from the Corporation's portfolio?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Now I understand that real return bonds carry an inflation adjusted return.

Is that right?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Now in that section of the Hum and Simpson report -- would be the sixth paragraph of that section, it begins with the phrase, "MPI appears to have followed Aon's advice." I don't know if it's still on your page 10 or...

MR. DON PALMER: It's on page 11, if I get the right paragraph. And you'd like me to read that in?

MS. CANDACE EVERARD: I would.

MR. DON PALMER: Again, from the Hum and Simpson report:

"MPI appears to have followed Aon's advice. Aon has essentially calculated their optimal investment frontier without regard to possible future inflation risk. Aon assumes that a future inflation will be within the Bank of Canada's current target range for the duration of the horizon of the portfolio and implicitly that MPI is willing to accept this inflation range. MPI's forecast is based upon 2 percent the next five (5) years."

MS. CANDACE EVERARD: What is the Corporation's view on the content of that paragraph?

MR. DON PALMER: It's absolutely false.

MS. CANDACE EVERARD: And why do you say that?

MR. DON PALMER: Included in -- in the Aon report, the assumptions are stochastic. There is an inflation assumption that has a -- a range of return or a range in it. So all the scenarios that they model which is a thousand different scenarios, inflation does have a standard deviation so there would be other inflation scenarios that would be included in the modelling.

If I may -- may add to that. With -- without regard to possible future inflation risk, again I would talk in terms of the study not being piece by piece but on an overall basis. And included in the modified portfolio 11, are real estate as an asset class and infrastructure as an asset class, which are also inflation sensitive. So you get the protection of that inflation protection plus increased diversification which you would not get with the real return bonds.

MS. CANDACE EVERARD: And we will talk about the real estate and infrastructure in -- in a little bit more detail. However, before we leave this portion of the Hum and Simpson report, we'd like to get on the record some further evidence from the Corporation.

In the next paragraph, the one that begins, "Consider the rationale given by Aon", and then there's a quote from the Aon report inserted into this Hum and Simpson document in the indented portion, so it would appear that Hum and Simpson are noting that Aon concluded that inflation is constrained by the Bank of Canada. There's a reference to the ten (10) year period ending in 2006, and that this may not pose an issue in the development of the portfolio.

What is the Corporation's response to that piece which I appreciate we're now talking about the quote from the Aon report?

MR. DON PALMER: I think that's an observation with regard to the current inflation environment and we would agree with that statement -- that paragraph.

MS. CANDACE EVERARD: Okay. After Drs. Hum and Simpson quote that piece from the Aon report, they go on at their question numbered 1 to state that the situation today has materially changed from 2006.

And my question for you is: Does the Corporation agree given the increases in oil and commodity prices referenced by Drs. Hum and Simpson in the same section, that there may be a higher inflation risk that is closer to the high end of the Government of Canada range than was the case prior to 2006?

MR. DON PALMER: The assumptions and they do refer to realized volatility of -- of December 31, 2006, but remember that their assumptions were actually made near the end of 2007.

So I would say that to start, the question is -- does have an error in it. But that said, I think the Bank of Canada certainly still does have inflation as a target.

And within the modelling, the range of the 2 percent plus or minus, the standard deviation, we think properly incorporates that -- that risk.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Now it's my understanding that at present the Corporation's investment portfolio does include some real return bonds?

MR. DON PALMER: Yes, it does.

MS. CANDACE EVERARD: And that's to the extent of 12.5 percent of the portfolio?

MR. DON PALMER: Yes, that's correct.

MS. CANDACE EVERARD: What is the approximate value of those bonds? Just ballpark.

MR. DON PALMER: Very round numbers -- actually, I'll just check on that and we'll give it to you very quickly.

(BRIEF PAUSE)

MR. DON PALMER: Just to keep things moving, we'll take that as an undertaking.

MS. CANDACE EVERARD: Now I appreciate

the evidence that you gave a couple of moments ago about the acquisition of real estate and --

MR. DON PALMER: Just in -- in round numbers 12 1/2 percent of $2 billion is $250 million, if that's close enough then we'll leave it at that. If you need a more exact figure then we can get that.

MS. CANDACE EVERARD: That's fine. Thank you.

MR. DON PALMER: Thank you.

MS. CANDACE EVERARD: So I appreciate you gave evidence a couple of moments ago about the acquisition of real estate and infrastructure investments to deal with inflation risk.

Has the Corporation considered or -- or would it not consider holding some fraction of the real return bonds? Or -- or why is it that it is electing to reject that type of bond completely in favour of the other piece?

MR. DON PALMER: A couple of points on that. Again, in terms of the transition out of real return bonds that could take several years, again depending on the favourable time to sell those investments.

So this is not something that we're looking at tomorrow to -- to put $250 million of real return bonds in the marketplace.

Again, it's a question of diversification. We feel that as far as inflation protection, real estate and infrastructure are better diversified with inflation rate risk.

I guess you also have to realize that even long bonds are, as the Chairman pointed out this morning, are -- are certainly correlated with inflation.

As inflation moves up, the return on -- on bonds would -- would increase as well, so they're not fixed like a real return bond would be, but there's certainly a correlation there.

(BRIEF PAUSE)

MR. DON PALMER: Again, with that inflation protection that I talked about, the real yields on infrastructure and real estate have been higher than that of real return bonds as well.

So if you're going to pick a security that's inflation protection, you may as well pick the one (1) with the higher -- a real yield.

MS. CANDACE EVERARD: Okay. You said a moment ago that the Corporation does not intend to dispose of all of its real return bonds in the immediate future.

Do you have a sense of over what period of time that will occur?

MR. DON PALMER: Okay, first it -- it's not MPI's decision to get rid of all the real return bonds; it's -- that's the decision of Department of Finance, and the timing of that would be up to them.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Just so that we understand the -- the situation correctly, we know that the Corporation does have members that sit on the working group, because we've talked about that this morning.

So -- and we know that the working group made the decision with respect to which portfolio of Aon's would be modified, and that that modified portfolio would be the one (1) selected by the Corporation.

So are you saying that even though the working group, which includes members of the Corporation, had input and some control up until that point, that once the decision is made to go with that portfolio, then control over the implementation is completely relinquished?

I just want to make sure that I'm

understanding what you're saying correctly.

MR. DON PALMER: We have input through the Investment Committee Working Group, but to characterize that working group as the ultimate decision-making body I think would be -- would be inaccurate.

So -- so again it's -- it's consultation with the Department of Finance. They have legislative authority over the investments. It's not -- there is no legislative authority bestowed upon the investment committee working group, so to speak.

So -- so yes, it's input into the decision- making process, but it's not up to the Investment Committee Working Group to come up with a consensus, or -- or to sign off decisions; those absolutely fall within the mandate of the Department of Finance.

MS. CANDACE EVERARD: And do you have any sense as to what the timing is going to be relating to the transition?

I know you said earlier this morning you didn't know the exact timing, that it would take a period of years, but is there anything more specific that you can put on the record at this point?

MR. DON PALMER: I'll stick with a period of years.

THE CHAIRPERSON: Mr. Palmer, would it be fair to say that the Finance Department may have different objectives than MPI?

Put it this way, more complex objectives?

(BRIEF PAUSE)

MS. MARILYN MCLAREN: Mr. Chairman, I think it's certainly fair to say that the Department of Finance in its entirety has more and different objectives than Manitoba Public Insurance.

I'm not sure it's fair to say that the section of the Department of Finance charged with responsibility for investing funds of Manitoba Public Insurance has different objectives with respect to those responsibilities.

THE CHAIRPERSON: But one (1) of their objectives is the sale of Manitoba bonds, is it not? The placement of bonds.

I'm not trying to unduly complicate it, I'm just suggesting --

MS. MARILYN MCLAREN: Yeah.

THE CHAIRPERSON: -- that your mandate and objectives are more limited than the Department of Finance.

MS. MARILYN MCLAREN: They are definitely. And -- and, you know, I think it's -- the broad Department of Finance is responsible for -- for selling those bonds.

THE CHAIRPERSON: Not right now. It's -- it's difficult to know who's responsible for your investment returns, whether it's the Corporation or it's the Department of Finance.

The Department of Finance has the final say, correct?

MS. MARILYN MCLAREN: Yeah, I -- it's not difficult at all for me to say, it's the Department of Finance. It -- it's Section 12.1 of the Manitoba Public Insurance Corporation Act. That's their legislator responsibility; we give them the money.

It's at -- at the pleasure of the Minister of Finance that there is an Investment Committee Working Group made up of representatives from both organizations.

We -- we try very hard to -- to build consensus and to have congruence but if -- if there is a difference of perspective at a different -- the -- the deciding body will be the Minister of Finance.

THE CHAIRPERSON: Thank you.

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Just while we're talking about the transition to the new mix, I'll just have a couple of questions for that and then I'm going to go back to Hum and Simpson and the real return bond issue.

So you've said, Mr. Palmer, that this transition to the new asset mix is going to take a period of years. You can't give us anything more specific than that.

Can you tell us when the timing will be known?

MR. DON PALMER: Depends on the spreads and the favourable timing of disposing of those bonds. So again, Department of Finance are the bond traders and it's their judgment as -- as to when those transactions are ultimately finished.

MS. CANDACE EVERARD: Has there been any start to the chain of transactions? Has anything been done to move towards the new mix as of today?

MR. DON PALMER: No.

MS. CANDACE EVERARD: Okay. Thank you.

So coming back to the section of the Hum and Simpson report that deals with real return bonds.

They make the statement and this is in my copy of the report, it's at the bottom of page 11. I'm going to guess in yours it's at page 12.

It's the paragraph that beings "The fact that Aon recommended bonds with a long maturity". It's the third or second last paragraph in the section.

MR. DON PALMER: The last paragraph on page 12.

MS. CANDACE EVERARD: Excellent. So Hum and Simpson essentially seem to be making the statement that if inflation increases and there are no real return bonds in place, there will be some exposure.

And I appreciate your evidence about the real estate and infrastructure investments being used to address that issue.

Is there anything in this paragraph or any other factors that would cause the Corporation to reconsider the decision to move away from real return bonds?

MR. DON PALMER: No, I don't think so. Again, remember that there is the ability to trade as inflation becomes more or -- or less of a factor.

And that the fact that there is or will be other inflation protection with real estate and infrastructure, I don't think this is a consideration.

MS. CANDACE EVERARD: You've said that the real estate and infrastructure investments will have some higher yields, that they'll have an international component.

Can you explain --

MR. DON PALMER: Not real estate. The decision has been to invest only in Canadian real estate.

MS. CANDACE EVERARD: Thank you for clarifying that. Other than those factors, that is the yield and the international component on the infrastructure side, can you explain for the record any other aspects of note with respect to those investments?

MR. DON PALMER: Add to that diversification, and I think you've got the list.

MS. CANDACE EVERARD: Now given the choice of using the real estate and infrastructure investments as a means of incorporating a hedge against inflation, does this add meaningfully to the risk of volatility of returns?

(BRIEF PAUSE)

MR. DON PALMER: The ultimate call through diversification is to reduce risk, so although there may be some volatility in the different asset classes, they're correlated negatively with the other classes within the asset mix, so overall the risk will be mit -- mitigated.

MS. CANDACE EVERARD: Thank you.

The next section in the Hum and Simpson report that I would like to draw your attention to is the one (1) that follows the one (1) we've just been speaking of, and it's entitled, "A Revenue Stabilization Suggestion."

MR. DON PALMER: Page 13.

MS. CANDACE EVERARD: Thank you.

Essentially it would appear that Drs. Hum and Simpson are suggesting that the Corporation take an annual fixed amount draw of investment income from the portfolio, based on a weighted average to avoid variations in investment income.

Does that sound to you like what they're suggesting?

MR. DON PALMER: I think that's what they're suggestion -- suggesting. I have no idea how it would work in practice.

MS. CANDACE EVERARD: My next question was going to be what was the Corporation's view, and would it be difficult to implement, so you've probably just answered that.

Is -- is there anything else that you would like to say on behalf of the Corporation with respect to this proposal?

MR. DON PALMER: There is a distinction that has to be made with forecasting of income and the actual taking of income.

For rate-setting purposes, it's a forecasting exercise. So what they've described as -- I forget -- the revenue stabilization suggestion is really not that far off what we do from a rate-setting perspective.

We do have an assumption with regard to capital gains, both -- on -- on the bond side. We have an assumption with regard to equity re -- returns, that would include capital gains, with our equity risk premium.

We -- we do forecast what the expectation of interest rates will be and build those into our forecasts. So from a rate stabilization perspective, this is pretty close to what we do.

In terms of actually taking the revenue, I don't know how you take a draw of returns that you're not actually getting, certainly with the accounting -- accounting rules, the way they are structured.

There's a very important caveat at the end of that section that says:

"Note however this strategy does not speak to the issue of whether there will be enough investment income in the first place."

I think that's pretty important. If -- if you're going to draw it, I mean, you better have it. So I -- again I -- I'm not quite sure how this ever works in practice; from a forecasting perspective, it's pretty close to what we do.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Thank you.

With respect to the switch of the asset mix in general terms, is it the Corporation's view that the target asset mix will be changed in the future if market conditions change materially?

MR. DON PALMER: The investment policy statement will always be a living document. So certainly, we're not looking to make changes as a knee -- knee-jerk reaction to market conditions.

For instance, we've seen an awful lot of volatility in the last week; we haven't changed our investment policy statement.

So -- so I think over a longer period of time that the Investment Committee Working Group, the investment committee of the Board and certainly Department of Finance always will have an eye on the investment policy statement and it may very well change over time.

MS. CANDACE EVERARD: Can you give a sense of how often the mix may be revisited? How much permanence one can expect for this new mix that's going to be implemented?

MR. DON PALMER: There are ranges built in to the investment policy statement so there is a little bit of flux. I would say that likely we would be looking to do another asset liability management study in another four (4) or five (5) years. It had been four (4) or five (5) years since we did the last one. Very likely, we will do one in another four (4) or five (5) years and probably four (4) or five (5) years after that.

So again, it -- it's something that we will continue to monitor and continue to study. We think that looking at it in terms of changing policy every four (4) or five (5) years is certainly adequate.

MS. CANDACE EVERARD: Thank you.

I'd like you to turn back to Tab 12 of the book of documents which is the question and answer at number ten (10) posed by the Board in the first round and, in particular, sub (c) of that question relates to the investment policy statement that you were just speaking of. Can you confirm for the record who the author is of that document?

MR. DON PALMER: You're talking about the investment policy statement?

MS. CANDACE EVERARD: Correct.

MR. DON PALMER: Yeah, MPI management is -- authors it and the investment committee of the Board would be responsible for acceptance of this document. It's their jurisdiction to accept this.

Management holds the pen after ICWG agrees what it's going to say. So -- so ICWG also includes this in -- as part of the deliberations. The actual drafting of the statement is done by MPI management.

MS. CANDACE EVERARD: And when you're speaking of ICWG, that's the same Investment Committee Working Group that we've been speaking of earlier with respect to the Aon report, just for the record?

MR. DON PALMER: Yes, that's correct.

MS. CANDACE EVERARD: Mr. Palmer, can you explain for the record the role of the Department of Finance in establishing the investment policy statement managing the fund, et cetera?

MR. DON PALMER: The Department of Finance is responsible for the investing of MPI's assets. They're with the Working Group. As you have stated, there is some discussion with regard to how the -- the assets are invested but the role of Department of Assets is they do it and they have ultimate decision making power to do it.

MS. CANDACE EVERARD: That's the Department of Finance?

MR. DON PALMER: Absolutely.

MS. CANDACE EVERARD: So does the Department of Finance play a role other than through the Working Group and the establishment of the investment policy statement?

MS. MARILYN MCLAREN: Yes, but -- but first of all, it has a very fundamental role as part of the Investment Committee Working Group in developing it.

In my experience, there has never been a time that something has gone from the Investment Committee Working Group to the Investment Committee of the Board of Manitoba Public Insurance that is not fully supported by all the pertinent leadership and groups of Department of Finance.

So it's not -- the people at the Department of Finance are accountable to -- ultimately accountable to the Minister of Finance. In my experience, there's never been a time when anything has gone from those members, the DO -- the Department of Finance members Investment Working Group has never agreed to have something go to the Investment Committee of the Board of Manitoba Public Insurance that they have not already vetted through their leadership of the Department of Finance. So there's a very fundamental role that the -- the bigger DOF plays in everything that goes to the Investment Committee of the MPI Board.

MS. CANDACE EVERARD: Thank you.

Now, we know from looking at the version of the investment policy statement that's attached at 10-C that this document underwent some changes in March of 2008 and then another set of changes in June of 2008.

That's right?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: One of the changes implemented in March, 2008, appears to have been in Article 5.2 of the investment policy statement, which is at page 12. And this -- the answer to this IR has in -- closer to the beginning of it or at -- firstly, the March changes and then it's followed by a second version of the same document with the June changes, so I'm looking at the March changes, and the date is referenced at the bottom of the page next to the page number.

MR. DON PALMER: Yes, I understand.

MS. CANDACE EVERARD: So if we're looking at Article 5.2, one of the changes that was made in that paragraph was to add in the second sentence, the phrase, "value at risk", such that reads:

> "Risk can be defined by the standard deviation of returns. The sharp ratio, value at risk and other commonly used risk measures for the total MPI portfolio..."

Et cetera, et cetera.

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Now in the bubble to the right-hand side, in the right-hand margin, which I believe is a track change that reflects words and phrases that have been deleted, it appears in the third bubble, the phrase:

> "Risk tolerances to be approved annually by the committee."

Do you see that?

MR. DON PALMER: I see that, yes.

MS. CANDACE EVERARD: So I take that to mean that while risk tolerance was previously to be approved by the committee, that provision has now been deleted from this document?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And why was that deleted?

(BRIEF PAUSE)

MR. DON PALMER: I think the risk tolerance is implicitly in an appropriate level of risk so that definition is not there but that would include a risk tolerance. It's not explicitly approved by committee as to a risk -- risk tolerance but that would be included in there, the measure of an appropriate level of risk.

MS. CANDACE EVERARD: Okay. I'm not sure if I totally understand that. Now that the provision that risk tolerance is to be approved annually by the committee has been deleted, who approves risk tolerance from and after March of 2008?

MR. DON PALMER: It -- it still is within the purview of the committee. I think the -- the defi -- to say -- or the deletion of that risk tolerance is really -- it was very difficult to define that risk tolerance as -- as a finite measure, so the risk tolerance is still there, but it's -- it's in the words, "the appropriate level of risk."

So we haven't deleted any duties of the investment committee by -- by that. It's just firming it up a little bit because it -- it seems that there -- with the words, "risk tolerance", that it would be a finite measure of that, and we didn't have a finite measure of that.

We have sort of risk definitions through those various measures, but we don't have a -- a finite. Yes, we will have a target sharp rate ratio and a tar -- a target standard deviation, et cetera.

MS. CANDACE EVERARD: So what is the Corporation's definition of the phrase, "appropriate level of risk"?

(BRIEF PAUSE)

MR. DON PALMER: Within our contracts with the investment managers, there is a -- a constraint on the amount of risk that they can have; that it can't be more than the risk in the benchmark. So that is one (1) of the -- the levels, and that's measured by the measures that we have listed there.

So again, as -- there are the benchmark risk targets that we would certainly consider. This document, the ALM document, and the whole efficient frontier, has different levels of risk.

And -- and it's a little bit subjective when there's always a trade-off. So to put my hand on -- finger on it and say that some given standard deviation or sharp ratio is the appropriate level of risk, I don't think it's quite that simple.

MS. CANDACE EVERARD: So are you saying that you can't point to specific methods, or ways that the Corporation is going to monitor the risk?

MR. DON PALMER: The methods are these measurements that are listed in section 5.2, which we measure and we look for red flags, but to say that there's a specific measurement that we have as a target for each of those, it's more based on the benchmarks of -- of the various investment classes.

MS. CANDACE EVERARD: Has the Corporation undertaken a value at risk calculation in establishing the portfolio mix, now that value-at-risk has been added to the list?

MR. DON PALMER: We do a value-at-risk calculation monthly.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay, so the Corporation conducts the value-at-risk calculation monthly, and then how does the Corporation use that calculation going forward?

What does it do with it?

MR. DON PALMER: That's one (1) of our usual agenda items at the working group, is to -- to look at -- to monitor the risk of the -- the current risk of the portfolio.

And if it's going to -- rising and going to an un -- unacceptable level, then at that point I'm sure the Department of Finance would -- would do some sort of action in terms of to change the mix, or to change the investment structure.

(BRIEF PAUSE)

THE CHAIRPERSON: While we have the delay, Mr. Palmer, just returning to an earlier subject.

So when you are talking about the working group, is there any outside professionals involved? Outside of the Department of Finance; outside of MPI.

MR. DON PALMER: We, on a regular basis, invite presentations from our investment managers to come and -- and provide input.

They would -- wouldn't -- or they don't sit on the working group, but they provide input and information to the working group, but there are not any external regular members of the working group.

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Palmer, you mentioned that the Corporation is undertaking value-at-risk calculations on a monthly basis. In recent months, what is the result of those calculations?

Is -- are there red flags that -- that you mentioned that are becoming apparent, or does it appear satisfactory?

(BRIEF PAUSE)

MR. DON PALMER: In recent months, it has increased. We don't feel that it's increased to any unacceptable levels at -- at the current time.

MS. CANDACE EVERARD: So what would the Corporation consider to be a red flag, to use the phrase that you did a few moments ago?

MR. DON PALMER: On a one (1) month

basis, we'd be looking at a measure of about 3 percent of assets at 95 percent, interval.

MS. CANDACE EVERARD: So -- so you mean a 3 percent change?

MR. DON PALMER: A 3 percent decrease in the value of the portfolio.

MS. CANDACE EVERARD: Now this value-at-risk analysis that we've been discussing, that is something that has historically formed part of the risk analysis that the Corporation has undertaken, is that correct?

MR. DON PALMER: It was part of it, in my recollection, yes.

MS. CANDACE EVERARD: Thank you.

Moving for a moment through to the June 2008 revisions, which appear at 10(c) on page 5 of the investment policy statement, it's reflected under the heading of "Equities":

"That the working group..."

This is in the second paragraph under the heading of Equities on page 5:

"That the working group shall annually review the risk, return, and diversification of the equity holdings in the fund, and will report the results to the investment committee."

What are the parameters of that review?

(BRIEF PAUSE)

MR. DON PALMER: Can -- can you specify what you mean by "parameters"?

MS. CANDACE EVERARD: Is -- is there a particular framework that has been pre-established within which that review will be conducted?

(BRIEF PAUSE)

MR. DON PALMER: We would look at some of the standard risk measurements that we talked about pre - - in your previous question with regard to standard deviation, sharp ratios, et cetera.

We'd also be looking at the returns probably on a rolling four (4) year basis. We'd also be looking at the diversification of the portfolio compared to benchmarks.

It is a standard report, about thirty-five (35) page report on the entire portfolio that's done annually, yes.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Now on page 18 of the same document there's reference to the classification of investments, and we'll have a section of questions relating to that issue.

It's noted that "Purchases prior to June 1st, 2008..." This is at the bottom underneath the chart on page 18:

"Purchases prior to June 1st, 2008 are classified as available for sale. Purchases on or after June 1st, 2008 are classified as held for trading."

MR. DON PALMER: That's just on marketable bonds. Just for clarification.

MS. CANDACE EVERARD: Thank you. What is the rationale for that re-designation?

MR. DON PALMER: In -- essentially the designation has to do with where capital gains show up on your financial statements.

Under "Available for Sale," any unearned capital gains will show up in your accumulated other comprehensive income statements.

If designated as "held for trading" then the changes in unearned capital gain show up in your income statement. Coincident -- and again, this is half of the story, the other story is the liabilities which are also interest -- interest rate sensitive.

So by putting your marketable bonds in as "held for trading," we're getting a match in the changes in value between our assets and our liabilities to mitigate the changes in our income statement.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So is it the case that the characteristics of the asset originally classified as "available for sale" changed? Or is that not the case?

MR. DON PALMER: No. With the original designation, that designation on a security/security basis is irrevocable.

According to the CICA handbook -- I think it's Section 38-55.80 of the CICA handbook, I know that one well -- when we purchase new securities, as you -- at the time of purchase is the time that you can designate whether they're "held for trading" or "available for sale," and all purchased after June 1st will be designated as "held for trading."

(BRIEF PAUSE)

MS. CANDACE EVERARD: I just have one (1) follow-up question with respect to the role of the Department of Finance that we spoke of a few minutes ago.

To what extent is the Department of Finance involved in the forecasting the -- of the level of investment income and equity gains?

MR. DON PALMER: They're not part of the Revenue Forecast Committee.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. Still in the investment policy statement, I understand that at pages 12 and 13 -- and I'm looking at the June one just because it's the most recent -- reflected on those pages are the investment return objectives for the Corporation.

Is that correct?

MR. DON PALMER: Yes, I have it.

MS. CANDACE EVERARD: Can you review the various benchmarks for the Board?

MR. DON PALMER: And you'd like me to read them all in?

MS. CANDACE EVERARD: Can you paraphrase

them, summarize them?

(BRIEF PAUSE)

MR. DON PALMER: For fixed income, we use the DEX Index. Don't ask me what "DEX" stands for because we don't know, and I don't think it stands for anything. It's a -- it's a market -- market index for measurement of bond returns.

On equities, for Canadian equities, we look at the S&P/TSX, plus a hundred and fifty (150) basis points. For US equities, we look at the S&P 500 total return, plus a hundred and fifty (150) basis points for large cap equities.

On small and mid-cap equities in the US, we use the Russell 2500 value total return index, plus a hundred and fifty (150) basis points.

The new asset class of -- of EAFE, we use the MSCI EAFE Index, plus a hundred and fifty (150) basis points, and we have not set the benchmarks for the alternative investments of real estate, private equity, and infrastructure.

MS. CANDACE EVERARD: Thank you.

If we can turn then to Tab 15 of the book of documents, which is the question and answer at 16 posed by the Board in the first round, comparison of the expected and actual returns.

Firstly, can you confirm for the record that it's the Corporation's investment managers that are managing these figures?

MR. DON PALMER: I would confirm that the investment managers are man -- managing the -- the assets. I wouldn't say managing these figures.

MS. CANDACE EVERARD: All right. Thank you. For the fiscal year ending 2008, which is the left most column on the chart, it would appear that the actual overall return was 4 percent compared with a benchmark for the same period of 4.1 percent.

Is that right?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And getting into some detail in that column, the actual return for the Canadian large capitalization equities was 3.5 percent compared with a benchmark of 8.3 percent?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And with respect to the small to mid capitalization equities, Canadian, the actual return for the year ending 2008 was 2.3 percent compared with a benchmark of negative 4.7 percent.

Is that right?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: I take it from just speaking of the small to mid capitalization Canadian equities for the moment, that there were no such investments on the part of the Corporation prior to the 2006/2007 fiscal year?

I say that because the balance of the chart has the letters "N/A" for each of those entries.

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Continuing to look at the figures for the year ending 2008. Under the US line, it would appear that the actual return for large capitalization equities was a negative 7.7 percent compared with a benchmark for the same period of negative 2.1 percent?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: And it would appear looking to the right along that same line in this chart, that in prior years there were more positive returns: 11.4 percent, 4.9 percent, 14.9 percent?

MR. DON PALMER: Yes. This is the first year listed that it has been negative, yes.

MS. CANDACE EVERARD: And with respect to the last line of the chart dealing with small to mid capitalization equities, still US, the actual return for the year ending 2008 was negative 24.8 percent compared with a benchmark for the same period of negative 8.2 percent.

Is that right?

MR. DON PALMER: Sadly, yes.

MS. CANDACE EVERARD: And again, the returns in previous years 18.7 percent, 3.2 percent and 7.7 percent were much more positive?

MR. DON PALMER: Yes.

MS. CANDACE EVERARD: Can the Corporation comment on this variability in returns in the US equities?

MR. DON PALMER: Especially on the -- the small and mid cap, it is certainly -- has a lot of variability, somewhat expected; although I don't think anybody would expect us to have a return of negative 24.8 percent.

But certainly there is variability in that particular asset class. And the -- the other equity classes are variable as well, but certainly large cap would be less variable than small cap.

MS. CANDACE EVERARD: Now it would appear from looking at this column that we just reviewed, the Canadian equities versus the returns on the US equities, that the returns on the Canadian side have obviously been much more favourable.

What does that represent, the relativity between the two (2) in the Corporation's view?

MR. DON PALMER: I would say that the chart essentially speaks for itself that in recent past the Canadian equity returns have been greater.

I don't know that I -- I would read anything more into that.

MS. CANDACE EVERARD: Okay. And who is it that manages the US equity portion of the portfolio? Is it the same or not?

MR. DON PALMER: We have a manager dedicated -- designated to US large cap. And currently our small and mid cap US portfolio is managed on -- managed passively. We don't have an active manager.

MS. CANDACE EVERARD: Now we've reviewed the negative experience on the US side in the last fiscal year ending 2008. To what extent has that experience influenced the Corporation's decision not to implement the weighting recommended by Aon with respect to US equities?

Has it been a factor, a significant factor or not at all?

MR. DON PALMER: We would have a longer term view than -- than one (1) year. Even four (4) or five (5) years when you're looking at investment return probably isn't a long enough time horizon, but it's certainly enough to influence some decision-making. I wouldn't deny that. But we would look on a longer term view than -- than even the four (4) years.

MS. CANDACE EVERARD: With respect to the small to mid capitalization equities on the US side, you said a moment ago that those were being managed passively, that there wasn't a manager in place, so who makes the decisions with respect to those investments if there's no investment manager? What -- what do you mean by passive management?

(BRIEF PAUSE)

MR. DON PALMER: Those returns would -- or manage -- match to an index rather than actively managed on a security-by-security basis.

(BRIEF PAUSE)

MS. CANDACE EVERARD: In general terms, speaking about the -- the portfolio or the equities as a whole, is the Corporation satisfied with the performance of its investment managers?

MR. DON PALMER: The Department of Finance did have under contract a small and mid cap equity manager up until earlier this year and that arrangement was terminated. I think that speaks for itself. So, no, we were not happy with -- or the Department of Finance was not happy with the returns in the small -- US small and mid cap.

MS. CANDACE EVERARD: What about the extent of satisfaction with the balance of the equities in those investment managers?

MR. DON PALMER: As long as we're under benchmark we're -- we wouldn't be happy with that but certainly short-term there are reasons for that and -- and we will continue to monitor that.

MS. CANDACE EVERARD: Has the Corporation taken any corrective measures, used broadly, other than the Aon recommendations, given the returns in the year ending 2008?

MR. DON PALMER: And again, the Department of Finance taking corrective measures, there has been some amount of assets that was taken away from one (1) manager. There -- as I mentioned, there was another manager that was terminated. So there are sort of active management of the managers, so to speak.

MS. CANDACE EVERARD: Thank you. Okay.

We'll turn then to Tab 14 of the book of documents which is the question and answer asked by the Board in the first round number 14 and, in particular, the last page which is the 14(b) attachment. This attachment reflects that as of June 30th, 2008, there were some $10.7 million in realized gains that had been taken in the portfolio to that date, is that right?

MR. DON PALMER: Sorry, could you repeat that?

MS. CANDACE EVERARD: Sure. Attachment 1-14(b), which is the last page at that tab, reflects that there were realized gains as of June 30th, 2008, of $10.7 million?

If I'm reading that incorrectly, please tell me.

MR. DON PALMER: And -- and looking at that, I think this is our undertaking that we committed to yesterday.

MS. CANDACE EVERARD: I believe that there has been an undertaking given to give an update as to the realized gains but this was as of June 30th, 10.7 million?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: What has the effect of recent market events been on the Corporation's portfolio?

MR. DON PALMER: The market value has taken a kicking, if that's a technical term.

MS. CANDACE EVERARD: Can you confirm whether the Corporation's portfolio has decreased by more than 3 percent?

MR. DON PALMER: No, it's not more than 3 percent.

THE CHAIRPERSON: This is because of the high bond component?

MR. DON PALMER: That -- that's correct.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: We spoke a moment ago about realized gains to date and there's already been an undertaking given there. Can you provide an undertaking to advise of the extent of the Corporation's unrealized gains, or losses as the case may be, as of August the 31st, 2008?

For clarity, it would be the change in unrealized gains for the period.

MR. DON PALMER: We'll take that as an undertaking.

--- UNDERTAKING NO. 14: MPI to advise Board of the

extent of the Corporation's
unrealized gains or losses as
of August the 31st, 2008

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Now we understand that the Corporation has instituted changes on how it accounts for its financial instruments due to comprehensive accounting. Can you explain that in -- at a high level?

MR. OTTMAR KRAMER: What would you like explained?

MS. CANDACE EVERARD: The change in accounting of -- or for the Corporation's financial instruments due to comprehensive accounting.

MR. OTTMAR KRAMER: The change that we just instituted on the held for trading or the change that we instituted March 1st, '07?

MS. CANDACE EVERARD: The March 1st, '07, transitional adjustment.

MR. OTTMAR KRAMER: As of March 1st, '07, the CICA handbook required us to show certain investments at market value. Investments that are -- were held for trading or available for sale were supposed to be on the balance sheets, supposed to be held at the current market value.

Investments that were held to maturity continue to be held at cost. The difference between an available for sale or a held for trading asset is -- is where you recognize that unrealized gain to the extent that that asset has not been sold.

And I'm -- I'm providing quite a summary here but on a -- on an available for sale asset, any unrealized gain, movement in the market, whether up or down, is flown through a new statement called other comprehensive income and those unrealized gains accumulate in -- in that other comprehensive income in an account called accumulated other comprehensive income.

Held for trading investments, those unrealized gains or losses are immediately recognized on the income statement and would flow through net income and into retained earnings, and that's the primary difference between an available for sale, held for trading, or held for maturity asset. Again, it's -- it's quite a summary but I think that characterizes it.

MS. CANDACE EVERARD: Thank you.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So the balance of

the accumulated other comprehensive income that you spoke of will be recognized in income when securities are disposed of or sold?

MR. OTTMAR KRAMER: Yes, that's correct. There's only one (1), however, is if an asset is permanently impaired, i.e. the value is thought to be permanently -- it will not recover, that asset can be written down or should be written down and then that unrealized loss is recognized in net income.

MS. CANDACE EVERARD: And has the Corporation experienced any of those impairments?

MR. OTTMAR KRAMER: Yes, we did have an impairment write-down for our annual report for the year ended February 29th, '08.

MS. CANDACE EVERARD: What are the details of that issue?

(BRIEF PAUSE)

MR. OTTMAR KRAMER: As contained in our annual report for the year ended February 29th, '08, we had -- just a second.

(BRIEF PAUSE)

MR. OTTMAR KRAMER: Okay. I'm -- I'm turning to the Universal Compulsory Automobile Insurance Annual Audited Statements, and the write-down of investments for the year ended February 29th, '08 was $7.8 million.

MS. CANDACE EVERARD: What page are you on?

MR. OTTMAR KRAMER: I'm on page 5 of 23 on the Statement of Cash Flow.

MS. CANDACE EVERARD: So you're on the left-hand column, the last item under the heading of Non Cash Items where it says Write-Down of Investments 7.783.

MR. OTTMAR KRAMER: Yes, that's correct.

MS. CANDACE EVERARD: What was the investment?

MR. OTTMAR KRAMER: There was numerous investments. Annually we go through a process of valuing or looking at all our investments to determine whether the -- the asset is impaired or not as required by the -- the CICA handbook.

MS. CANDACE EVERARD: And was this 7.7 comprised of total loss?

MR. OTTMAR KRAMER: What's your definition of total loss?

(BRIEF PAUSE)

MS. CANDACE EVERARD: When I used the phrase "total loss" I was referring to funds that would not be recovered in the future, that are permanently impaired.

MR. OTTMAR KRAMER: Yes, the handbook requires us to write down the assets that we feel are permanently impaired to the value that we think they're impaired to, based on a valuation by Department of Finance.

(BRIEF PAUSE)

MS. CANDACE EVERARD: And are these investments being tracked by the Corporation?

MR. OTTMAR KRAMER: Yes, we still hold those assets so, yes, we do still track them. But there will no -- there will not be -- if -- if the asset were to increase, which is unlikely because we have written them down, there would be no unrealized gain recorded on those assets.

MS. CANDACE EVERARD: Would these write-downs be reversible under the IFRS provisions?

MR. OTTMAR KRAMER: I don't know the IFRS provisions in detail but I believe there is a provision for recognizing some write-ups of -- of written-down assets but I -- we haven't investigated that fully yet. But under the current handbook pronouncements we do not recognize any gains if they do happen.

MS. CANDACE EVERARD: Okay. Coming back to the issue of other comprehensive income I -- I take it that gains and losses that are recognized in other comprehensive income flow to the statement of operations when the investments are sold?

MR. OTTMAR KRAMER: That's correct. When the investment is sold a gain or loss that it was previously unrealized in other comprehensive income or accumulated other comprehensive is income is then recognized on the income statement.

MS. CANDACE EVERARD: Now, in the most recent annual report provided by the Corporation, at page 52, it is reflected that there -- in the statement of accumulated other comprehensive income that as of the year end there was some $23.1 million. What is the composition of that sum?

MR. OTTMAR KRAMER: Those are unrealized gains, unless I'm not understanding the question correctly. What do you mean by composition?

MS. CANDACE EVERARD: So these funds

represent items that will flow to the bottom line when they are sold?

MR. OTTMAR KRAMER: There is the potential for that to flow to the bottom line if there is not future losses or future gains. Those are gains that have not been realized to date based on cost and the market difference.

MS. CANDACE EVERARD: The Corporation provided an answer to the Board in response to question 7 asked in the first round which deals with the realization of gains and there's a statement in that answer -- this is not in the book of documents -- that corporate policy regarding the realizing of gains may be reviewed in the future.

Has that occurred at this point?

MR. DON PALMER: No.

MS. CANDACE EVERARD: And is there an indication that can be put on the record as to when that will occur?

MR. DON PALMER: No.

MS. CANDACE EVERARD: The Corporation has put some evidence on the record at question 3 posed by the Board in the third -- in the second round, pardon me -- this is not in the book of documents either so this is question 3 posed by the Board in the second round --

dealing with two (2) transactions that were triggered to realize gains.

Can you describe, for the record, those two (2) transactions?

MR. DON PALMER: On April 27th and June 22nd of 2007, we recognized that there was unearned gains within the portfolio, and we went to the managers and we said we'd like to recognize $25 million in gains in the Canadian equities and $4 million in gains in the US equities, on April 27th, and similarly, on June the 22nd, recognition, like recognition of $10 million in gains in Canada and $3 million in the US portfolio.

MS. CANDACE EVERARD: Now at question (b) of that IR the question was posed to advise of the extent to which the investments sold were repurchased.

And the answer reads:

> "Generally, holding sold to realized gains are repurchased based on the investment manager's view of the market. ,"

which doesn't really seem to tell us whether in these two (2) specific transactions the investments that were sold were repurchased.

So can -- can someone give us that information?

MR. DON PALMER: I think on last year's evidence we had said that something over 90 percent of sales were repurchased.

So I don't know if that's specifically for these two (2) transactions but I would say that it would be most of those two (2) transactions would be repurchased.

MS. CANDACE EVERARD: Mr. Chairman, I'm about to go to another section if this would be an appropriate time for the afternoon break?

THE CHAIRPERSON: Sure. Just if MPI doesn't mind, is to summarize some of our thoughts as we're building up. Just a few short ones here.

One (1), just to remind us private equity and infrastructure investments, these don't have to be equity positions I presume, they could also be debt security?

(BRIEF PAUSE)

MR. DON PALMER: They would be primarily equity.

THE CHAIRPERSON: Thank you. Overall in -- in doing the various runs of the potential portfolios, was a higher equity component beyond 20 percent, say, rejected due to expected higher volatility?

Was the reason in the end in your preferred portfolio you didn't go higher on the equities was because of the attended higher volatility?

MR. DON PALMER: The -- the construction of the efficient frontier doesn't quite work that way in terms of specific assets.

There are a number of portfolios that are built so -- so to speak and then the model is run and then where they come out, they come out.

So I would say that the higher -- the higher risk portfolios that would have contained higher equity exposures would be rejected on that basis, but I wouldn't characterize as saying specifically they were rejected because of higher equities.

THE CHAIRPERSON: I was just looking at your -- the charts in the Aon report and the higher excess returns that are associated with higher volatility and, based on the runs you run, they all have higher equities in them.

MR. DON PALMER: Yes. And -- and that's not by accident. That's how the numbers play out and so it was the portfolio that rejec -- we rejected because of the high volatility, not because it was equities.

THE CHAIRPERSON: I think we're saying

the same thing.

MR. DON PALMER: I think we are too.

THE CHAIRPERSON: The third question was a more general one just to probably underline the significance of the investment portfolio.

Looking at the charts and the various runs, it hits me that the portfolio that you selected compared to the existing one, trying to fit it here, appears to increased the expected excess return from .25 to 1 percent. Is that correct?

That's my reading on it, that your existing portfolio was slated at .25 and just trying to target this one, it looks like it's 1 percent. Is that a fair approximation?

MR. DON PALMER: That sounds about right, yes.

THE CHAIRPERSON: This suggests on a $2 billion portfolio an expected extra return of about 14 million a year or 22 million on 3 billion. Is that a fair estimate?

MR. DON PALMER: Yes.

THE CHAIRPERSON: And just playing with numbers, the present value of 14 or 22 million runs somewhere around $300 million, does it not?

If you had $14 million a year basically

forever, it would be worth at today's interest rates, around
300 million, wouldn't it?

MR. DON PALMER: It sounds reasonable. I can't confirm.

THE CHAIRPERSON: I'm just saying it's a lot of money that's all. I mean the size of the portfolio, when you change the portfolio and get a higher return on it, it has significant long-term benefits for the policyholders and the Corporation, it would appear.

MR. DON PALMER: Sure, I would agree with that.

THE CHAIRPERSON: Just a supposition, if MPI had more certainty as to this Board's reaction to future fluctuations in net income, would that allow for a different asset mix?

(BRIEF PAUSE)

THE CHAIRPERSON: You can think about it if you want.

MR. DON PALMER: No, that's okay. The -- the -- the risk profile of the Corporation certainly is constrained by what Aon characterized as a narrow band of -- of the RSR target. So if that was to increase, that -

- that would increase the Corporation's risk tolerance.

THE CHAIRPERSON: Thank you. We will take our break now.

--- Upon recessing at 3:00 p.m.

--- Upon resuming at 3:18 pm.

THE CHAIRPERSON: Ms. Everard...?

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: So I'd like to speak some more about the transitional and adjustment -- transitional adjustment arising from the comprehensive income accounting issue.

Mr. Palmer, I had the opportunity to review some of the evidence that you gave at last year's hearing. In particular, you testified, I believe, that you expected there would be increased volatility arising from the application of comprehensive income accounting?

MR. DON PALMER: I seem to recall that, yes.

MS. CANDACE EVERARD: And that the adoption of comprehensive income accounting would require the Corporation's actuary to amend the basis for the selection of a discount rate?

MR. DON PALMER: Yes, I remember that.

MS. CANDACE EVERARD: And that the discounting assumptions would change based on expected yields of the portfolio at the time of evaluation?

MR. DON PALMER: Yes, I remember that.

MS. CANDACE EVERARD: Now I understand that, at the time of last year's hearing, the actual evaluation of unplayed -- unpaid claims liability had not been completed because that would have been done at the end of the last fiscal year, February of 2008?

MR. DON PALMER: We do a preliminary work at the end of October and then the full year-end at the end of the fiscal year so -- so neither of those would have been done, yes.

MS. CANDACE EVERARD: So did you know at the time of last year's hearing that there would be impact that would flow through to the income statement or, more particularly, an adjustment to the RSR?

MR. DON PALMER: Knew of the possibility of -- of that; we didn't know the exact quantum.

MS. CANDACE EVERARD: In the result or -- or at the end of the day, there was a re-evaluation of the RSR in the way of a $22 million reduction with no corresponding offset from the bond portfolio. That's right?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: Now there is reference in the book of documents of the Board at tab 25 which is the answer given by the Corporation to question 6 in the second round to this issue.

If the portfolio, the bond portfolio, had been --

MR. DON PALMER: Just one (1) -- one (1) second, Ms. Everard. My Tab 25 is blank so...

Okay. Thanks to Mr. Kramer, I have his.

MS. CANDACE EVERARD: Speak to someone at the office about that. If the bond portfolio had been classified as held for trading, I take it, based on the answer to sub (b), that there would have been a positive impact on the RSR as a result of the adjustment of some 27 million rather than the $22 million reduction, is that right?

MR. DON PALMER: No, I don't think that's exactly right.

MS. CANDACE EVERARD: Thank you. Can you explain the narrative portion of the (b) part of the answer, specifically the second sentence which says;

> "The RSR would have increased by 27 million had the bonds been designated as held for trading instead of

available for sale"?

MR. DON PALMER: Sure. That change in unrealized capital gain in the bond portfolio of that gain of 27.866 would have flown -- or flowed directly into the income statement rather than on accumulated other comprehensive income.

That would have offset the $22 million transition adjustment on the liability side. So that is a perfect explanation of the offset that will occur once we have all of the bonds designated as held for trading.

MS. CANDACE EVERARD: And when did the Corporation realize that the quantum of the adjustment would be a $22 million negative impact on the RSR?

(BRIEF PAUSE)

MR. DON PALMER: It was some time after the October 31 evaluation. At that time, we had done the evaluation and knew that there was adjustment to interest rates that we were -- had thought that we would flow through just the Q3 financial -- financials.

It was then our auditor who pointed out that really the -- because that was a change that was -- came into effect on March 1st, that that should be characterized as a transitional adjustment effective

March 1st of 2007.

So some time late in the fiscal year is when we determined that.

MS. CANDACE EVERARD: Now if I can direct your attention to the answer at part (a) of this IR which reads:

> "The Corporation did not fully understand the implications of the designation of marketable bonds as available for sale when the financial policy outlining the classification of financial instruments was established in January '07. This original decision is irrevocable with respect to specific investments classified at that time."

So does this mean that there was an oversight on the part of the Corporation or that it didn't fully understand the ramifications of the change?

MR. DON PALMER: Both of those. Yeah, we -- at the time it was early on in the -- in the game and, yes, we didn't fully understand the implications of the liabilities at that time.

MS. CANDACE EVERARD: And was it the reduction in the RSR that we've been speaking of that led the Corporation to re-designate new bond purchases as held for trading rather than available for sale?

MR. DON PALMER: I don't know specifically that it was the transition adjustment. It was the understanding of the volatility that could be introduced in the income statement that we thought better of our designation of bonds as available for sale.

And at that time -- first -- first thought that, because year end hadn't happened yet, we might be able to designate them in for 2007. That's when we discovered that irrevocable actually means they're irrevocable. So the -- the auditor said no, you can't re-designate that for -- at some time in the future for new purchases. You can re-designate -- or for new purchases at some given time you can re-designate but there's no retroactivity to that.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Had the Corporation classified bonds as held for trading on March 1st, 2007 and, all other things being equal, would the amount of the rebate ultimately ordered by the Board have increased?

MR. DON PALMER: That's very difficult for me to say just because the -- the basis of the rebate would have been 2007, February 2007, and then forecasts going forward.

(BRIEF PAUSE)

MR. DON PALMER: I think the -- the net difference is the $5 million, the twenty-two (22) and the twenty-seven (27) because at last year's hearing we didn't know about the twenty-seven (27) and we didn't know about the twenty-two (22) either. So I think, all things being equal, there likely would not have been a change.

MS. CANDACE EVERARD: But the amount of the RSR would have been larger?

MR. DON PALMER: Not known at the time of the hearing because at the time of the hearing we had -- we didn't have the $22 million either.

MS. CANDACE EVERARD: No, and -- and I appreciate that. But in retrospect the RSR would have been larger?

MR. DON PALMER: At the end of 2007/08, yes.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Okay. Just to clarify, Mr. Palmer, your evidence with respect to the 22 million and the 27 million, it's my understanding that the 27 million would be reflected under other comprehensive income and, therefore, would not affect the RSR, is that right?

MR. DON PALMER: I thought the question was: If it had been designated as held for trading what would the difference have been?

MS. CANDACE EVERARD: That was the question that I asked previously and you answered it but I am just now asking you to clarify that the 27 million was included in -- in terms of not the hypothetical of had the bonds been otherwise designated but, in fact, in the -- the scenario that did occur that the 27 million was part of other comprehensive income and did not form part of the RSR?

MR. DON PALMER: I think I followed the breadcrumbs and, yes, I agree.

MS. CANDACE EVERARD: Thank you. Okay. To what extent does the Corporation believe rate setting will be affected by this accounting policy change that we've been discussing?

MR. DON PALMER: It's my belief that this does not affect rates any.

MS. CANDACE EVERARD: And can you give the Board an idea of how long it takes for the whole of the Corporation's investment portfolio to turn over?

There's -- there's been an indication that it -- it may be approximately three (3) years, if that's of help to you.

MR. DON PALMER: I think you're talking about the bond portfolio and that we have said that approximately 40 percent of the bond portfolio turns over each year. But in each subsequent year, it's not a different 40 percent so I -- I don't think that you can say that the entire bond portfolio would turn over in two -- two and a half (2 1/2) years.

That would be inaccurate. Each year, it's 40 percent but the -- but what you buy this year, you still might turn over next year. So -- so it's not an additive process per se.

MS. CANDACE EVERARD: So what will be the impact on net income arising from the changes in unrealized gains in each of the categories?

(BRIEF PAUSE)

MS. CANDACE EVERARD: We will withdraw that question and proceed from there.

MR. DON PALMER: Thank you for that.

MS. CANDACE EVERARD: So I have a few questions relating to the international financial reporting standards. There's been a little bit of evidence given on those to this point in the hearing.

And it's our understanding that these standards, which I'll just refer to as IFRS for the record, will be a requirement for the year beginning January 1st, 2011, with comparative results required for 2010. So in other words, these standards will impact the year -- the fiscal year of 2011/'12 and the year 2010/'11 for comparative purposes.

Is that correct?

MR. OTTMAR KRAMER: Yes, that is correct.

MS. CANDACE EVERARD: Now if I can ask you to direct your attention to question forty-three (43) posed by the Board in the first round. It's the IR where the KPMG report was provided and it's not in the book of documents. I'm going to be referring to that report or that document from KPMG in some detail in a moment.

But firstly, I just wanted to confirm, Mr. Palmer, a piece of evidence that you gave yesterday morning or actually, it may have been the afternoon, to my colleague, Mr. Saranchuk.

Basically, in the brief discussion that

you and he had with respect to this IFRS issue, it was your evidence that it was your understanding that the application of these standards would not have a significant financial impact on the bottom line of the Corporation.

Does that ring a bell? And I do have the transcript reference if you'd like.

MR. DON PALMER: No, I -- I recall that, yes.

MS. CANDACE EVERARD: Has there been any analysis or internal communication of the impact of IFRS on the Corporation?

MR. DON PALMER: No, we have actually had an RFP to choose an implementation partner for IFRS. That IFR -- that RFP -- too many letters here. That RFP has in fact closed. We are in the process of selecting that implementation partner but we're not -- we're not there yet.

Part of that process will be -- all the implications of IFRS in getting us ready for conversion.

MS. CANDACE EVERARD: Turning to the KPMG document which is attached to the IR that I referenced, number 43, and in particular the second bullet on that page which begins with the phrase "Insurance contracts measurement."

Are you with me?

MR. DON PALMER: What page was that?

MS. CANDACE EVERARD: Page 4.

Is it correct to say that in that paragraph, among other things, KPMG is making the statement that insurance contracts will be discounted using market rates that will be somewhat lower than portfolio rates which will lead to higher discounted liabilities?

MR. OTTMAR KRAMER: Yes, I believe that's what KPMG is saying.

MS. CANDACE EVERARD: And on the same page, the last bullet, which begins with the phrase "Date of recognition of insurance contracts," is it correct to say that KPMG is making the statement that insurance contracts may have to be recognized where a constructive obligation arises rather than on the effective date of the policy, as a result of which some system and procedural changes may be necessary?

MR. OTTMAR KRAMER: Yes, I think that summarizes again what KPMG is saying. However, I think you need to look at the top of the page 4, KPMG has -- has a little blurb where it says "Proposed new IFRS standards for measuring insurance contracts." Those haven't been finalized yet.

So because that hasn't been finalized we don't know what the final rules will look like for the IFRS rules, so this is their understanding of what may happen. So it hasn't been determined what the impact will yet be or when it will be.

MS. CANDACE EVERARD: Still in this KPMG document, if I can ask you to turn to page 3.

Page 3. On the left-hand side of the page there's a chart under the heading of "Insurance Accounting," can you confirm the Corporation's understanding of that chart which indicates the impact of the IFRS on profit and loss?

MR. OTTMAR KRAMER: I believe KPMG has put the -- the P&L statement or the entire income statement as high, that's not necessarily the bottom line impact but that's on the overall statement. It could be classifications, it could be disclosure, et cetera. It's on the P&L statement, not on the bottom line.

MS. CANDACE EVERARD: Turning then to page 6 of the same document, the KPMG document, in the section entitled "Financial Instruments" on page 6, and looking at the fourth bullet, KPMG appears to be making the statement that the use of the "held for trading" designation is more strict under the IFRS than under Canadian GAAP.

Can you tell us whether the Corporation has reassessed whether these bonds can be contin -- can continue to be designated as held for trading on the transition to FRIS -- IFRS?

MR. DON PALMER: It's our position that we still will be able to use the "held for trading" and I base that on the -- the first sub bullet of the fifth bullet that says:

> "An entity can designate a financial asset or financial liability as measured at fair value, i.e. held for trading, when the designation eliminates or significantly reduces an accounting mismatch arising from the measuring of assets and liabilities or from recognizing the related gains and losses on different basis."

So that's exactly why we designated as "held for trading," so I think this certainly covers that.

(BRIEF PAUSE)

MS. CANDACE EVERARD: Is it the case that the whole of the bond portfolio can be re-designated at the time of this transition such that it will all be re-designated within two (2) years?

MR. DON PALMER: It -- it can all be reclassified at the time we implement IFRS.

MS. CANDACE EVERARD: Thank you.

MR. DON PALMER: That's -- yeah. So at the beginning of 2011/'12.

MS. CANDACE EVERARD: Thank you.

Turning to page 8 of the same document. This is under the section entitled "Provisions and Contingencies" which begins on page 7 and continues onto page 8.

In the second-last full paragraph on the page which begins with the phrase "Provisions for Loss Making Executory Contracts."

Are you with me?

KPMG makes the statement that provisions for those types of contracts which it calls onerous contracts, are required under IFRS, and it makes a statement at the last sentence of that paragraph that as an example the Corporation's master agreement with the Province of Manitoba relating to the driver and vehicle licensing operations will need to be further analyzed.

Does the Corporation agree that that particular agreement is an onerous contract?

MR. OTTMAR KRAMER: Those were not our words, those were KPMG's words. We will be looking at this contract to see if any provisions would apply. But that shouldn't and would not impact the basic operations.

MS. CANDACE EVERARD: And I appreciate that this isn't an MPI document but what I was trying to get at is whether the Corporation agreed that that contract was an onerous one and you seem to be saying that that's something that it will be reviewing.

So a decision has not been made as to its opinion on that score?

MR. OTTMAR KRAMER: Yes, that would be correct.

MS. CANDACE EVERARD: Are there any other contracts that the Corporation has identified as onerous within the meaning of that term as it's being used here?

MR. OTTMAR KRAMER: Not at this time.

MS. CANDACE EVERARD: Mr. Palmer, in the discussion that you had with Mr. Saranchuk yesterday with respect to some of these IFRS issues, you were asked about re-evaluating a plant and equipment to fair market value as part of the transition adjustment.

Has the Corporation made any decisions with respect to fair market value adjustments on the land that it owns?

MR. OTTMAR KRAMER: Currently we're -- we're still at the preliminary stages. We've received this report and as -- as Mr. Palmer has indicated, we're looking at -- at some proposals for IFRS services.

So at this point in time we haven't made any decisions yet. We're going to be evaluating all our options and to see what is the best for Manitoba Public Insurance.

MS. CANDACE EVERARD: I'll ask you to turn to question 13 posed by the Board in the second round, which is not in the book.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So I'm at 2-13 posed by the Board, sub (a), which reflects in the response that the next phase of the IFRS implementation project will deal with specific accounts and estimates of financial and disclosure impacts.

And the second sentence reads:

"Qualitative disclosure of IFRS differences will be published in the February 28th, 2009 Annual Report."

When is it expected that this next phase referenced in the first sentence that I just read will be completed?

MR. OTTMAR KRAMER: When we published or -- I gave this response, it was our understanding that qualitative disclosures were to be required for discussions with some of the firms that are going to be -- that potentially may be providing us IFRS services. They've indicated that they -- the qualitative disclosures will not be required.

So, like I said, that was our understanding when we answered that question and as we're -- as we choose our implementation partner and get more information, we will know more and we will ensure that we meet all the requirements for the IFRS conversion.

(BRIEF PAUSE)

MS. CANDACE EVERARD: So if I understand your evidence correctly, the Corporation has been advised that the qualitative disclosure referenced in this answer is no longer required. When does the Corporation anticipate that it will have to begin the disclosure process that accompanies the transition to IFRS?

(BRIEF PAUSE)

MR. OTTMAR KRAMER: As I previously indicated, we're not assure -- we're not aware of all the details around IFRS and we're currently going to be choosing a partner and working with that partner to ensure that we meet the obligations. We may have disclosure in our MDNA (phonetic).

We may have disclosure in our financial statements. It's -- it's based on what advice and guidance and understanding we have of the IFRS disclosure requirements.

So right now, I -- I can't give you a specific date as to when we will have that information and when we'll be disclosing it and to what level of detail; however, we will be IFRS compliant.

MS. CANDACE EVERARD: Mr. Chairman, I'm about to move into a new area. Noting the time, does -- if it would please the Board, should we adjourn for the day?

THE CHAIRPERSON: Okay, we will adjourn. We will see everyone back at 9:00. Thank you.

--- Upon adjourning at 3:50 p.m.

Certified correct,

____

Cheryl Lavigne, Ms.